DOCUMENT RESUME

ED 342 345 HE 025 320

TITLE	Hearings on the Reauthorization of the Higher Education Act of 1965: Stafford Loans. Hearings before the Subcommittee on Postsecondary Education of the Committee on Education and Labor. House of Representatives, One Hundred Second Congress, First Session (Washington, DC, June 6, 12 and 19, 1991).
INSTITUTION	Congress of the U.S., Washington, D.C. House Committee on Education and Labor.
REPORT NO	ISBN-0-16-035717-9
PUB DATE	91
NOTE	362p.; Serial No. 102-43. Portions contain small, marginally legible print. For related documents, see HE 025 317-319.
AVAILABLE FROM	U.S. Government Printing Office, Superintendent of Documents, Congressional Sales Office, Washington, DC 20402.
PUB TYPE	Legal/Legislative/Regulatory Materials (090)
EDRS PRICE	MF01/PC15 Plus Postage.
DESCRIPTORS	Access to Education; Educational Legislation; Federal Aid; *Federal Legislation; Financial Needs; Financial Support; Hearings; Higher Education; Loan Default; Paying for College; Postsecondary Education; *Student Financial Aid; *Student Loan Programs
IDENTIFIERS	Congress 102nd

ABSTRACT

This document is a record of testimony presented during a series of three hearings concerning changes that may be needed in the Stafford Loan Program, which each year generates the largest amount of financial assistance for college bound students. Testimony was heard from witnesses representing all sectors of postsecondary education, as were suggestions from representatives of those institutions and persons involved with the program: institutions, students, lenders, financial aid administrators, guaranty agencies, and the Student Loan Marketing Association. Among the witnesses were the following: Michael Farrell, Acting Assistant Secretary, Office of Postsecondary Education, U.S. Department of Education; Selena Dong, Legislative Director, United States Student Association, Washington, D.C.; Lawrence A. Hough, President and Chief Executive Officer, Student Loan Marketing Association; Donald A. Saleh, Director of Financial Aid and Student Employment, Cornell University; and Joe Belew, President, Consumer Bankers Association. The texts of four related House bills, H.R. 179, H.R. 709, H.R. 1482, and H. R. 2336, are provided. Numerous prepared statements, letters, and supplemental materials submitted by witnesses and others are also included. (GLR)

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HEARINGS ON THE REAUTHORIZATION OF THE HIGHER EDUCATION ACT OF 1965: STAFFORD LOANS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON POSTSECONDARY EDUCATION

OF THE

COMMITTEE ON EDUCATION AND LABOR
HOUSE OF REPRESENTATIVES

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

HEARINGS HELD IN WASHINGTON, DC, JUNE 6, 12, AND 19, 1991

Serial No. 102–43

Printed for the use of the Committee on Education and Labor

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U.S. GOVERNMENT PRINTING OFFICE
47-221 ⇆ WASHINGTON : 1991

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Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-035717-9

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CONTENTS

Page

Hearings held in Washington, DC:

June 6, 1991 1
June 12, 1991 157
June 19, 1991 301
Text of H.R. 179 322
Text of H.R. 709 336
Text of H.R. 1482 303
Text of H.R. 2336 172

Statement of:

Farrell, Michael, Acting Assistant Secretary, Office of Postsecondary Education, U.S. Department of Education, Washington, DC; Selena Dong, Legislative Director, United States Student Association, Washington, DC; William L. Banks, Vice President, Chemical Bank, Jericho, NY; Carl Donovan, President, Northwest Education Loan Association, Seattle, WA; Lawrence A. Hough, President and CEO, Student Loan Marketing Association, Washington, DC; Joe Paul Case, Dean of Financial Aid, Amherst College, Amherst, MA; Gerald Murphy, Director, Universal Technical Institute, Glendale Heights, IL; and Donald W. Grigley, Senior Vice President, Connecticut National Bank, Hartford, CT 10
Penny, Hon. Timothy J., a Representative in Congress form the State of Minnesota 307
Petri, Hon. Thomas E., a Representative in Congress from the State of Wisconsin 158
Saleh, Donald A., Director of Financial Aid and Student Employment, Cornell University; John P. Whalen, Chairman, University Support Services; Thomas A. Butts, Associate Vice President for Government Relations, University of Michigan; Joe Belew, President, Consumer Bankers Association; and Patricia Smith, Director of Legislative Analysis, American Council on Education 204
Shaw, Hon. E. Clay, Jr., a Representative in Congress from the State of Florida 326

Prepared statements, letters, supplemental materials, et cetera:

Association of American Medical Colleges, prepared statement of 344
Banks, William L., Vice President, Chemical Bank, Jericho, NY, prepared statement of 36
Belew, Joe, President, Consumer Bankers Association, prepared statement of 250
Butts, Thomas A., Associate Vice President for Government Relations, University of Michigan, prepared statement of 230
Case, Joe Paul, Dean of Financial Aid, Amherst College, Amherst, MA, prepared statement of 86
Dong, Selena, Legislative Director, United States Student Association, Washington, DC, prepared statement of 21
Donovan, Carl, President, Northwest Education Loan Association, Seattle, WA, prepared statement of 53
Farrell, Michael, Acting Assistant Secretary, Office of Postsecondary Education, U.S. Department of Education, Washington, DC, prepared statement of 12
Gaydos, Hon. Joseph M., a Representative in Congress from the State of Pennsylvania, prepared statement of 8
Grigley, Donald W., Senior Vice President, Connecticut National Bank, Hartford, CT, prepared statement of 123

Page

Prepared statements, letters, supplemental materials, et cetera—Continued
  Hough, Lawrence A., President and CEO, Student Loan Marketing Association, Washington, DC, prepared statement of 65
  Klug, Hon. Scott L., a Representative in Congress from the State of Wisconsin, prepared statement of 306
  Medical Society of the State of New York, prepared statement of 341
  Murphy, Gerald, Director, Universal Technical Institute, Glendale Heights, IL, prepared statement of 110
  Penny, Hon. Timothy J., a Representative in Congress from the State of Minnesota, prepared statement of 309
  Petri, Hon. Thomas E., a Representative in Congress from the State of Wisconsin, prepared statement of 161
  Saleh, Donald A., Director of Financial Aid and Student Employment, Cornell University, prepared statement of 207
  Sawyer, Hon. Thomas C., a Representative in Congress from the State of Ohio:
    Prepared statement of June 6, 1991 7
    Prepared statement of June 12, 1991 300
  Shaw, Hon. E. Clay, Jr., a Representative in Congress from the State of Florida, prepared statement of 327
  Smith, Patricia, Director of Legislative Analysis, American Council on Education, prepared statement of 271
  Whalen, John P., Chairman, University Support Services, prepared statement of 219

HEARING ON THE REAUTHORIZATION OF THE HIGHER EDUCATION ACT OF 1965

THURSDAY, JUNE 6, 1991

House of Representatives,
Subcommittee on Postsecondary Education,
Committee on Education and Labor,
Washington, DC.

The subcommittee met, pursuant to call, at 9:45 a.m., Room 2175, Rayburn House Office Building, Hon. William D. Ford [Chairman] presiding.

Members present: Representatives Ford, Williams, Hayes, Miller, Lowey, Sawyer, Payne, Unsoeld, Andrews, Jefferson, Reed, Roemer, Kildee, Coleman, Petri, Roukema, and Gunderson.

Staff present: Thomas Wolanin, staff director; Jack Jennings, education counsel; Maureen Long, legislative assistant; Gloria Gray-Watson, administrative assistant; Jo-Marie St. Martin, minority education counsel; and Rose DiNapoli, minority professional staff member.

Chairman Ford. I am pleased to convene the Subcommittee on Postsecondary Education for this, the 18th hearing in a series of 44 on the reauthorization of the Higher Education Act. Today is the first of three hearings on the Stafford loan program, which generates the largest amount of financial assistance each year.

Federal contributions of $4.24 billion during this fiscal year will generate about $11 billion in loan capital, providing almost 4 million students and their parents with guaranteed loans to attend postsecondary institutions; 3.2 million of these students will receive subsidized loans.

Today we will hear testimony from witnesses representing all sectors of postsecondary education and all the players in the Stafford student loan program—institutions, students, lenders, financial aid administrators, guaranty agencies and the student loan marketing association—all with suggestions for changes in the loan program.

And I'm particularly pleased that Michael Farrell, the Acting Assistant Secretary for the Office of Postsecondary Education at the Department of Education has joined us here again. You're soon going to set a record, Mike, for appearances on reauthorization, but we're very pleased to have you.

Mr. Farrell. I'm glad to be here.

Chairman Ford. And I was very pleased in the presence of others to report to the Secretary last night that every time you've appeared here you've been helpful to the process and he's well represented.

Today we will hear suggested reforms to the Stafford loan program, which is becoming one of the most costly problems, and that the program itself faces—the default problem. While the net default rate for Federal guaranteed student loans has not increased over the past 10 years, this is important. Ten years ago the student loan default rate was 9.7 percent; in 1989, it was 9.6 percent. So it's actually come down very slightly in a period when anxiety about loan default costs has gone up.

And I hope in our discussion we can keep a separate view of the cost of defaults, the accumulated portfolio out there and the rate of defaults. Too frequently, when it's written in the press, those two terms are confused and it gives the public the idea that during the 10 year period, the rate of defaults has increased.

So they think that more students are being less responsive than was previously the case. They don't make the distinction because it isn't made for them in the newspaper. When we're talking about this tremendous annual cost, we're talking about paying for the cost of loans that have been made ever since the beginning of the program, not what the current status is.

I look forward to hearing the comments and suggestions of the witnesses we have today on ways to improve the Stafford loan program. We have prepared statements from all of the witnesses, which we've had time to examine. Without objection, the full prepared text will be inserted in the record immediately following the oral presentation by each of the witnesses.

Mr. Coleman.

Mr. COLEMAN. Thank you, Mr. Chairman. The student loan aspect of Title IV and of its programs that help families and students attend colleges and universities, is an integral part of it. And I would like to take this opportunity to make a brief statement because I think it's helpful for us to clarify our situation here.

Mr. Ford and I have agreed to a hearing schedule which I think now numbers in the forties, as far as the number of hearings. And we're doing it on an issue basis. Today the issue is GSL's, yesterday and the day before were two days of Pell grant hearings, and so forth.

At the same time, Mr. Ford and I, as we have done in past years, have agreed that it probably would not be constructive to produce legislation to place in introduction or before the committee in advance of going through this process. And I want to confirm that, that both myself and Mr. Ford have kind of given up that option now until these matters have all been heard. Then we will try to put together some legislation afterwards and try to come up with a bipartisan approach to these major issues regarding which we're having all these hearings.

Having said that, I know that there may be legislation introduced that has any impact on these various programs as we go through the process, and those can be helpful and we will certainly take those into consideration when the time comes. But I want to remind you that we don't have a particular markup vehicle or a bill and, basically, we are going to hold in abeyance those options, at least for the Chairman and this member, in the hopes that we might be able to ultimately put together a proposal that would not be divisive, but uniting. And we feel that this is the best way of doing it.

So if there are those who wonder where my bill on such and such is, or why Ford hasn't introduced his bill, that's the reason. Others on the panel may have their own bills to introduce; there are other members involved. But there may be some questions from time to time regarding that.

I know the Chairman and I have just visited with the Secretary regarding that issue, and I think he understands our position and respects it as well.

Thank you, Mr. Chairman.

Chairman FORD. I want to thank the gentleman for bringing that up. I think it should be made clear to people that Mr. Coleman and I solicited from all of the education establishment, if you will, back in January your specific recommendations to be given to us, I think, it was by April the 8th.

Those have been collated and were put in a side by side form so that everybody can see what everyone else is suggesting and what their rationale is for it. This is the same procedure we followed 5 years ago in reauthorization.

We, at the same time, have promised people that there would not be a Ford bill or a Coleman bill or a Democratic bill or a Republican bill or an administration bill standing by itself in front of people as we went through the hearing process. We're trying to proceed through the hearing process examining all of the facets of Title IV as concepts rather than being for or against anybody's particular initiative.

And it should be clearly understood. We met with the Secretary before their legislation was introduced. I believe it's being introduced today, or will be before tomorrow. It's up here now and we have a copy.

We have no prejudice against that because neither of us are cosponsoring, even by request, and we explained to the Secretary that it would be inconsistent. Mr. Williams has, introduced a Middle Income Student Assistance Act that I have had a long and abiding interest in. And I've resisted becoming a co-sponsor on that for the same reason.

And I don't want anybody to think I've given up on that idea. I'm going to be fully supportive of Pat's efforts at the appropriate time, but it would not be fair for us to superimpose our ideas of legislation on the process before we find out what people think.

So the absence of the Chairman and the Ranking Republican from any bill that's introduced from any quarter should not be taken to mean anything other than what we have just explained. It's neither a repudiation of that legislation or a lack of interest in it or any indication it won't get full consideration. It's just a matter of trying to stay pure for as long as we can, and sooner or later that will break down, as you know, when we have to make decisions.

But I would add to that that in discussing Pell, for example, we discovered that the education community, the spokespersons that we've heard from, the organizations that we hear from most frequently, have come together with a common approach to the future of Pell earlier than they have ever done so in the past.

The publics and privates usually aren't even talking to each other by this stage in the reauthorization process, and they've already presented us with a unified approach, without a specific dollar amount attached to it. That's something that will have to be determined later, but at least it is an approach that unifies the segments of education as they haven't been this early in the process in the past.

Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman. As you mentioned, I have a bill that I introduced yesterday, with Majority Leader Gephardt, Caucus Chairman Hoyer, Ways and Means Committee Member, Mr. Downey. We will be seeking other co-sponsors, with the exception of the Chairman and the Ranking Minority Member, on that legislation.

It's a simple bill that simply extends Federal student financial aid to all students in this country, but most importantly, middle income students. They and their families are the bed rock of America's tax system, and yet they find it increasingly difficult to finance their children's college education.

Just 10 years ago, the average cost of a public school was $2,600; today it's $5,000. Just 10 years ago, the average cost of a private school was $6,000; today it's $11,000. College is quickly becoming out of the reach of middle income folks. And those families, I think most if not everyone would agree, are finding that they worry now about not being able to provide their children with at least as good education as their parents provided them.

I have another reason for introducing this bill, Mr. Chairman; it's political. It has to do with the political support for the Act that you and the rest of us are attempting to reauthorize. A student aid system that relies on the support of middle income people to fund it but provides them virtually no benefits from it is losing the support of the American people.

And at a time when we increasingly find cannibalism with regard to where scarce dollars are going to be spent, it seems to me that we need to significantly broaden the support of the loan and grant programs.

Briefly, Mr. Chairman, my bill does three things. It provides assistance under the guaranteed student loan program to all families without resort to a needs test. That means we do away with that cumbersome and complex loan application problem. Say that to folks and you'll hear them applaud.

Second, it removes the value of the family home and the family farm from the calculation of need for the other student aid programs, including Pell grants. That's going to make that program and others more accessible to middle income families.

And finally, Mr. Chairman and my colleagues and friends, it brings final decisions concerning the size of the Pell grants back to Congress, where many of us believe those decisions belong, rather than leaving them down at OMB. That will provide families with a better idea about the availability of the program to them when they're trying to figure out how to pay their children's college bills.

Mr. Chairman, I'm grateful for your remarks of support for the legislation that you made this morning, and I look forward to continuing to work with you and my other colleagues to see if we can't include middle income American students as recipients to a greater degree than they have been in the recent past of student financial assistance.

Thank you, Mr. Chairman.

Mr. **Coleman**. Would the gentleman yield?

Mr. **Williams**. I'd be pleased to yield.

Mr. **Coleman**. I thank the gentleman for yielding. As he knows, throughout this series of hearings that we've held so far, it has become clear that one of the prime efforts that this member has been involved with, and Mrs. Roukema, I know, has an interest in this as well, that the introduced legislation—and both of us in the past have pursued this—that it will be something that we, on this side of the committee aisle, will find great interest in. Perhaps with a few turns or twists from your legislation.

But the thrust of it is that we recognize the essential points that you've raised. And that is, first of all, that going to a college today, and paying tuition and room and board, is probably the second largest expenditure that a family will make, second only to the purchase of a home. That's a very important thing to remember for all people with all incomes.

The second thing is that for too long we have seen a removal of the middle class, the working middle class, from program eligibility. A loan program which was essentially designed by Mr. Ford and others, before we became members of this body, was created to serve that middle class. And they have been, basically, removed or driven out by budget concerns and considerations through the years.

So there we do have a political problem. The problem is the people who pay full tuition, the people who pay the taxes, are now being told when they fill out the forms, "I'm sorry. You're not eligible." So they pay twice, while others who are less fortunate financially may benefit, and others who are more fortunate financially can accept those costs. The middle class is being squeezed more and more and more.

You will find on this side of the aisle great sympathy and interest in this subject. And I believe that removing the home equity and family farm part of the formula will essentially help with this issue.

Non-liquid assets should never have been made part of that formula in the first place. Because the only way you can utilize those assets is to place a second or third mortgage on them, and endanger your own home or farm, or sell them in order for a member of the family to attend college. None of these options are good, and I hope that we can find a common ground to agree on.

Mr. **Williams**. I want to thank the gentleman for that indication of support, if not for the precise language of my bill, for the general thrust of it. And I, of course, Tom, know of your long support for it because you and I have visited about this for years and I'm looking forward to working with you and your colleagues on that side and seeing that before this Congress is out, we make middle income Americans eligible for significantly increased financial assistance from the Federal Government.

Chairman Ford. Mrs. Roukema.

Mrs. Roukema. I just want to acknowledge and associate myself with the remarks of Mr. Coleman, our ranking member, and reiterate that dating back to 1987, Mr. Williams and I worked on a number of aspects of this problem, particularly the fixed asset. We even passed that proposal out of this committee, the full committee, in 1987, or 1988, I guess. It did not get to the floor for a vote.

I won't go into the unfortunate fate of the Roukema amendment and the education act last year. It was not adopted, and I accept that. But had it been adopted, this provision would already be in law. It was not adopted at that time for other reasons. It was part of a comprehensive default program.

But I look forward to working with the majority on this subject, and most of all, to preserving access to higher education for low and moderate income groups. And I think there we stand unified in our commitment.

Thank you very much, Mr. Chairman.

Chairman Ford. Mr. Miller.

Mr. Miller. Nothing, thank you.

Chairman Ford. Mr. Gunderson.

Mr. Gunderson. Nothing at this time.

Chairman Ford. Mr. Hayes.

Mr. Hayes. Mr. Chairman, I want to thank you. Because of my crowded schedule today, I may not be able to remain until the person I'm about to present and introduce to you, who is a witness and a part of this panel from the State of Illinois, testifies.

I'm pleased this morning to have the opportunity to introduce Mr. Jerry Murphy, who will soon testify.

He's an educator by profession. Mr. Murphy is currently the director of Universal Technical Institute of Illinois. Having opened their doors in 1988, UTI of Illinois is one of the many Universal Technical Institutes across the country. Located in Glendale Heights, Illinois, this institution educates more than 600 students in automobile and diesel mechanic technologies, as well as air conditioning repair.

Mr. Murphy also serves as a member of the Education Committee of the Illinois State Chamber of Commerce. I want to welcome you, Mr. Murphy, a fellow Illinoisan, as well as all the other witnesses to the hearing today on Stafford loans. I certainly look forward to hearing your testimony, if I can remain, Mr. Murphy. I want to thank you, Mr. Chairman, for your indulgence in permitting me to make this introduction. I haven't learned yet to be in two or three places at the same time, so I do have to leave pretty soon.

Chairman Ford. Mr. Sawyer.

Mr. Sawyer. Mr. Chairman, I have a statement for the record, but I want to hear Mr. Hayes' friend sooner rather than later. So I won't say it now.

[The prepared statement of Hon. Thomas C. Sawyer follows:]

STATEMENT OF HON. THOMAS C. SAWYER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Thank you, Mr. Chairman, for calling this hearing on Stafford Loans.

If, as we heard during our previous hearings, Pell Grants are supposed to be the foundation on which Federal student financial aid programs are built, then Stafford Loans are the bricks and mortar.

In the 1970's the annual loan volume of Guaranteed Student Loans never exceeded $3 billion.

The volume total in 1990 was $12.3 billion.

In addition, an entire industry now exists which sends large volumes of money among banks, students, schools, collection agencies and even Wall Street.

The student loan program was created in 1965 to give middle class families some Federal assistance to pay college costs, without spending any Federal funds.

Clearly, the Stafford Loan program has changed in many ways since its conception and I look forward to hearing the witnesses testimony and participating in a comprehensive reevaluation of this program.

Chairman FORD. Mr. Kildee.

Mr. KILDEE. Nothing at this time, Mr. Chairman.

Chairman FORD. Mrs. Unsoeld.

Mrs. UNSOELD. No, thank you. I'm eager to hear the witnesses.

Chairman FORD. Anyone on the front row? Fine. Mr. Gaydos has a written statement for the record. Without objection, it will be inserted in the record.

[The prepared statement of Hon. Joseph M. Gaydos follows:]

Opening Statement
Joseph M. Gaydos
Postsecondary Education Hearing
June 6, 1991

The Higher Education Act of 1965 originally provided loans for students from middle income families and grants for more needy families. As we all know, these programs have evolved since then to the point where loans are the major vehicle of financing higher education for almost all Americans who need assistance to make their dreams a reality.

Today, even our most needy students are forced to incur huge debt burdens because the appropriate level of grant money just hasn't been there for them.

Of all students receiving federal assistance during the 1989-1990 school year -- almost three percent of those students with family incomes less than $12,000 received only loans according to preliminary data from the Department of Education. An additional 34 percent of these low income students received a combination of grants and loans.

For those students in this same income category who received grants but still had to borrow, almost 59 percent of them borrowed more than $2,000 and more than ten percent of these had to borrow more than $3,000.

Using conservative estimates, these students will owe at least $8,000 and many will owe more than $12,000 over the course of a four-year program.

The debt burden for middle income students is even greater because very few middle income students qualify for grants, and, when they do qualify, they receive smaller awards.

While the financial prospects of attaining a postsecondary education progressively worsened for these middle and lower income Americans, families increased their dependence on loans. But access to loans is not enough for far too many families. They can only borrow so much before they reach a limit where they know they will never be able to repay their debts.

We have all heard the tragedies of students hocking their belongings to pay their bills and parents having to choose which child they are going to send to college.

The people of this country deserve more than an empty promise that their children can be whatever they want to be when they grow up. Whether a child wants to be a doctor or a truck driver, he or she should have that opportunity.

We should not dictate which children will have the opportunity to follow their dreams and which will not based on their families economic situations.

Unfortunately, some students have been denied their educational dreams due to changes we have made during the cost-driven budget reconciliation process.

Hopefully, now that we have the opportunity to make true policy decisions regarding the grant and loan programs during reauthorization, we will find a way to solve the existing problems in the programs without making higher education even less accessible for students.

STATEMENTS OF MICHAEL FARRELL, ACTING ASSISTANT SECRETARY FOR THE OFFICE OF POSTSECONDARY EDUCATION, U.S. DEPARTMENT OF EDUCATION, WASHINGTON, DC; SELENA DONG, LEGISLATIVE DIRECTOR, UNITED STATES STUDENT ASSOCIATION, WASHINGTON, DC; WILLIAM L. BANKS, VICE PRESIDENT, CHEMICAL BANK, JERICHO, NEW YORK; CARL DONOVAN, PRESIDENT, NORTHWEST EDUCATION LOAN ASSOCIATION, SEATTLE, WASHINGTON; LAWRENCE A. HOUGH, PRESIDENT AND CEO, STUDENT LOAN MARKETING ASSOCIATION, WASHINGTON, DC; JOE PAUL CASE, DEAN OF FINANCIAL AID, AMHERST COLLEGE, AMHERST, MASSACHUSETTS; GERALD MURPHY, DIRECTOR, UNIVERSAL TECHNICAL INSTITUTE, GLENDALE HEIGHTS, ILLINOIS; AND DONALD W. GRIGLEY, SENIOR VICE PRESIDENT, CONNECTICUT NATIONAL BANK, HARTFORD, CONNECTICUT

Chairman **Ford**. The first witness will be Mr. Michael Farrell. As you've heard, your prepared statement is already in the record and it will appear with your comments. You can add to them your statements, highlight it or supplement in any way you think is going to be most serviceable to this record.

Mr. **Farrell**. Thank you, Mr. Chairman and members of the committee. I am pleased to appear before the committee today to discuss the department's recommendations for reauthorizing guaranteed student loan programs.

From my perspective, Mr. Chairman, I hope you won't mind my observing what I see as progress in education after two days. As I recall the panel on Tuesday, the odds were nine to one; today they look more like seven to one. And I'm wondering if I have a chance to work it down to even odds in the future.

Chairman **Ford**. From where I look, it looks about even right now.

Mr. **Farrell**. Thank you, sir. To sustain the effectiveness of the programs, we intend to focus the attention and resources of the department to improve the integrity of the program. Reports initiated and requested by Congress, the Inspector General's audits and reports, and the joint management study conducted by the Education Department and OMB all document significant problems that a lax system has permitted.

Our proposals are based on our analysis of the basic GSL structure that makes clear that while there are weaknesses in many aspects, the basic program is viable. Our proposals would make fundamental reforms in all parts of the program, reduce Federal risks, stabilize guaranty agencies, forge partnerships with States, establish stronger minimum quality standards, and improve default prevention and debt collection.

First, we reaffirm our commitment to access and choice by proposing increases in Staffords for all undergraduates, from $2,625 to $3,500 for first and second year, and to $5,000 for third, fourth, and fifth year undergraduates.

We propose an increased SLS for all except first year students. These increases would be from $4,000 to $6,000 for other undergraduates, and to $10,000 for graduate students.

Increased loan maximums complement our recommendations that grants focus aid more to the poorest students. Our proposals increase the amount of subsidized loans available to all families, I would say, by about 182,000 more loans, counting Staffords, PLUS and SLS.

The sum of these will further the Federal commitment to the program as a good investment. We propose a minimum course length of 6 months or $600 as a condition of institutional eligibility for student loan programs. This proposal makes the minimum length consistent with all Title IV programs and furthers default reduction.

The guaranty agencies are critical components. The collapse of the higher education assistance foundation illustrates the need for the Secretary to have additional authority to manage ailing guaranty agencies. We propose corrective management plans, minimum reserve requirements, and authority to terminate a guaranty agency's agreement.

Our proposals also authorize the Secretary to assume certain guaranty functions when a guarantor withdraws from the programs or if the Secretary terminates the agreement.

Conflict of interest safeguards and accelerated guaranty agency filings are other items included. We'd also like the Sallie Mae to report to the department when its loans to a guaranty agency or any lender exceed $50 million.

A fundamental premise of what we're offering is for States to take an active role in establishing licensing standards and monitoring the activities of a guaranty agency. To this end we propose the Secretary set minimum licensing standards. Each State would back its designated agency with the equivalent of the full faith and credit of the State.

Since lenders benefit from Federal student aid programs, we propose they also share the risks. Special allowance payments would be reduced by .25 percentage points to lenders with default rates exceeding 20 percent.

Secretary Alexander has committed us to working with you to obtain a program that expands access to postsecondary education, which restores integrity, in fact and in the mind of the taxpayers, and which supports education excellence.

Some of these many proposals are major, and others represent small goals or improvements. That isn't accidental; we're fixing a system grown elaborate in its provisions and participating organizations. They have done pretty well. They should share in the risk and they should share in the fixing.

The Secretary's priorities to me were to first get after the fixing, and then begin evaluating alternatives to the present systems. As you know, we will be providing some additional thoughts on gatekeeping, which we will submit along with any other measures we feel would contribute to your very thoughtful considerations.

I've received excellent assistance from this subcommittee and from your staffs. I appreciate your great knowledge and depth of experience, and I'll be happy to answer any of your questions at the appropriate time. Thank you.

[The prepared statement of Michael Farrell follows:]

DEPARTMENT OF EDUCATION

Statement by

Michael J. Farrell
Deputy Assistant Secretary
for
Student Financial Assistance

before the

House Subcommittee on Postsecondary Education

on

Reauthorizing the Guaranteed Student Loan Programs

Mr. Chairman and Members of the Committee:

I am pleased to appear before this Committee today to discuss the Department's recommendations for reauthorizing the Guaranteed Student Loan programs.

To sustain the effectiveness of the programs, we intend to focus the attention and resources of the Department to improve the integrity of the program. Then our dollars, loans and grants, will help to provide quality education and training for deserving students.

Reports initiated and requested by Congress, the Inspector General's audits and reports, and the Joint Management Study conducted by the Education Department and the Office of Management and Budget, all document the significant, deep-rooted problems that a lax system has permitted to develop. With the strong commitment and leadership of the Department, all parts of the education community must work together to ensure a strong and viable student loan program.

Our proposals are based on our analysis of the basic GSL structure that makes clear that while there are weaknesses in many aspects, the basic design is viable. Our proposals would make fundamental and far-reaching reforms in every dimension of the program. We would reduce Federal Government risks, stabilize guaranty agencies, forge stronger partnerships with States, establish stronger minimum quality standards, and improve default prevention and debt collection.

First, we reaffirm our commitment to access and choice by proposing to increase the maximums in the Stafford program for all undergraduates. These increased maximums would be $3,500 for first- and second-year undergraduates; and $5,000 for third-, fourth-, and fifth-year undergraduates. We are also proposing an increase in SLS maximums for all borrowers, except first-year students. These increased maximums would be $6,000 for other undergraduates and $10,000 for graduate students. These changes will help students meet the increasing costs of education and encourage persistence by providing additional loans to upperclassmen. Increased loan maximums also complement our recommendations that grant aid should be focused to deliver more aid to the poorest students. Our proposals increase the amount of subsidized loans available to all families.

We are recommending numerous actions to improve accountability. These include default reduction proposals, strengthening oversight of guarantee agencies, improved loan collection, risk-sharing, and measures aimed at eliminating "counterfeit" programs -- low-quality educational programs that leave students with debts, not a degree. The sum of these actions will ensure that the Federal commitment to the GSL Programs is a wise investment.

We propose to establish a minimum course length of six months or 600 hours as a condition of institutional eligibility for the student loan programs to reduce the incidence of default. This proposal would make the minimum course length requirement consistent for all Title IV student aid programs. We ask that lenders perform credit checks on prospective borrowers over the age of 21, and require a co-signer if the borrower has a poor credit history. Next, we propose to delay loan disbursements for 60 days to first-year students at schools with default rates over 30 percent. Lastly, we propose to require lenders to offer graduated repayment options to borrowers.

The guarantee agencies are critical components of the student loan programs. As the Department discovered last fall, with the collapse of the Higher Education Assistance Foundation, the Secretary needs additional authority to manage ailing guaranty agencies. We propose to require corrective management plans, including minimum reserve requirements. We request authority to terminate a guarantee agency's agreement if the Secretary determines that the agency is no longer able to perform its responsibilities. Our proposals would also authorize the Secretary to assume certain guarantee agency functions when a guarantor withdraws from the GSL programs or if the Secretary terminates its agreement. We also request conflict-of-interest safeguards to prohibit guarantee agency officers and employees from having a direct financial interest in any entity with which the agency has a business relationship.

We propose to improve guarantee agency operations by requiring their filing for reinsurance claims within 45 days after the lender guaranty payment is made, reimbursing actual administrative costs (up to one percent of loan volume), and requiring the Student Loan Marketing Association to report to the Department each time it makes a loan to a guarantee agency or any lender with an outstanding loan balance to exceed $50 million.

We propose to improve loan collections by requiring students to provide a driver's license number and other borrower locator information, and authorizing guarantee agencies and the Secretary to garnish a defaulter's wages.

A fundamental premise of our GSL proposals is that States should take an active role in establishing strict licensing standards for postsecondary programs, and to better monitor and regulate the activities of a guaranty agency. To this end, we propose that the Secretary set minimum licensing standards in regulations. Each State would back its designated guaranty agency with the equivalent of the full faith and credit of the State. We would also require States, where school default rates exceed 20 percent, to pay a share of the default costs. If

States are actively monitoring schools and guaranty agencies, these proposals would not be costly for the States.

Since lenders benefit from the Federal student aid programs, we propose that they share the risk of borrower default. Special allowance payments would be reduced by .25 percentage points to lenders with default rates exceeding 20 percent. This shared risk should reduce abuse in the GSL programs.

We are examining alternative approaches for ensuring that Federal aid is provided only to students who recognize the importance of education and who take their studies seriously. This includes an assessment of the current statutory provision that requires a student to maintain "satisfactory progress" toward a postsecondary degree or certificate. And, the 1990 Reconciliation provision would be further tightened by dropping the default rate threshold to eliminate schools to 25% in 1994 and make the school ineligible for all Title IV aid beginning in FY 1992.

We have the opportunity to strengthen this critical component of Federal student financial assistance. With the support of this Subcommittee, the Congress, Secretary Alexander's personal commitment, and the President's strong support for our efforts, I am confident we will do so. And quite frankly, the public demands it.

I have received meaningful assistance from the Subcommittee and your staffs, and I appreciate your program knowledge and experience.

I would be glad to discuss our proposals in more detail or to answer any of your questions.

Chairman **Ford**. Ms. Dong.

Ms. **Dong**. I'd like to thank Chairman Ford and the subcommittee for this opportunity to testify. My name is Selena Dong, and I am the legislative director of the United States Student Association, which represents 3.5 million postsecondary students.

While USSA recognizes that the Stafford loan program has enabled countless students to pursue a postsecondary education, we believe that a few changes are needed to the program, along with the program entitlement, to make our loan programs work most effectively in the interest of both students and our country.

First of all, USSA shares you concerns about the increasing cost of the Stafford loan defaults; however, we would like to always remember that the overall percentage of students defaulting on their loans has remained roughly steady over the past 10 years at about 10 percent. Hence, even though total student loan volume has quadrupled in the last 10 years, a consistent 90 percent of students to repay their loans.

Second, our efforts to curb abuse and achieve savings in the student loan program can not be at the expense of students' access to higher education. Origination fees, delayed disbursement and flexible treatment of students in deciding who is a defaulter and the cutting off of institutional participation in the student loan programs ultimately hurt students.

Too often, it is current and future students who must pay for the student loan defaults of the past. And all too often, what these students must give up to pay this price is their educational opportunity.

Third, there are many reasons why students default, including ones for which it is unfair to assign them blame. Half of student loan defaulters are dropouts from postsecondary programs who will not have the earning power of a college graduate and, hence, may want to pay back their loan but simply can not.

Hence, we must strengthen our investment in the retention programs, including the TRIO programs, that enable students to stay in school and not become defaulters.

Also, many students are not adequately counseled on the seriousness involved in taking out a loan. As one student at Mr. Hayes' field hearing testified, as a freshman he was told he could quickly and easily get a loan. And when he was forced to drop out temporarily because of a family crisis, he did not know about the grace period or deferment options or that he was supposed to pay back his loan. Not surprisingly, he's become another default statistic and he finds it extremely frustrating that he can not reverse his default status until he repays off the entire loan, which he simply can not do right now.

USSA thus supports efforts to improve students' understanding of the financial aid programs through a public advertising campaign on student aid, as well as enhanced training of high school counselors and financial aid administrators on the complexities of the student aid program.

This would ensure that students have all the information necessary to make good decisions and be informed student loan borrowers.

I will highlight just a few of USSA's proposals for the Stafford loan program. First, origination fees and assurance premiums should be eliminated. Right now lenders, who, of course, are my distinguished colleagues on this panel, can impose on Stafford loan borrowers an origination fee of up to 5 percent of the loan's principles and an insurance premium of up to 3 percent of the principle.

Attachment 1 of my actual written testimony is a lender notice to a Wisconsin student. You will notice that $229.40 was taken out of his loan, and yet he will be expected to pay off the full loan, plus interest, of course. This is clearly unfair.

Second, too many hard pressed middle and working class families who have been squeezed out of eligibility of the Stafford loan program into taking on the more onerous supplemental loans for students or PLUS loans for parents. These loans have high and variable interest rates, and students and parents have to repay the loan within 60 days of disbursement, as if they're any richer after 2 months. And if they choose to defer repayment until while the student is in school, the Federal Government does not subsidize the interest during the deferral.

The second attachment of my written testimony is an actual lender statement of a Louisiana student. You will notice that she's taken out a $4,000 SLS loan, but over the next 9 years, after paying off her SLS loan, she will have had to repay $8,362. It's crazy that poor people have to pay twice as much for their education.

So USSA recommends—and this is a little radical—the abolishment of the SLS programs unless they become more subsidized and manageable for students and parents.

I can also tell you about the New Jersey student who is from a single parent household who has been pushed out of Pell grant eligibility and will end up paying $4,000 in Perkins loans, $16,000 in PLUS loans, and $20,000 in Stafford loans for a 4 year education.

Third, to increase Stafford loan eligibility of students from working class and middle class families. USSA recommends removing the use of home and farm equity in Congressional methodology needs analysis, and wishes that this, indeed, was in the law.

Fourth, USSA recommends increases in Stafford loan limits for sophomores, juniors, seniors, and graduate and professional students.

Fifth, USSA strongly believes that less than half-time students should be eligible for Stafford loans.

Sixth, USSA recommends restoring the grace period back to 9 months, rather than the current 6 months.

Seventh, for those students who have loan debts in excess of $10,000, a graduated 15 year repayment schedule should be available rather than the current 10 year repayment period.

These last two proposals would help ease the number of loan defaults.

Eighth, the USSA recommends strongly that this committee consider repealing current mandated delayed disbursements of student loans and reject proposals for additional ones. Students depend on the prompt receipt of their loan money to pay for their tuition, rent, child care, transportation and so on. If they didn't need the money promptly, they would have not applied for it.

Delayed disbursement is forcing some students to drop out of school because they can not continue to afford to stay in. Many schools actually impose late fees on students whose late loan checks are not their fault. Other students are dropped from their classes, while others have holds placed on their student ID cards.

This is consistently one of the most voiced complaints of our student membership. If Congress is not willing to do away with these mandated delayed disbursements, USSA suggests that legislative language be added to the Higher Education Act that prohibits postsecondary institutions from penalizing in any way students whose late loan checks are not their fault. This clearly would help students stay in school and help other students start school.

Ninth, USSA believes that when determining who is a student loan defaulter, there must be some flexibility, especially in cases of fraudulent and/or closed schools. We were very disturbed to learn of the Department of Education's refusal to refigure the loans from Florida students whose signatures were forged on loan checks by fraudulent school owners who then closed the school. Clearly, there must be some flexibility in determining who is a student loan defaulter.

And lastly, USSA is very interested in the proposals regarding a direct lending program, especially the optional one proposed by American Council on Education. We are excited about the possibility of simplification of the loan application, delivery, updating and repayment process, the possible elimination of origination fees and insurance premiums, and the possibility of substantial savings that could be channeled into the grant program.

However, USSA asks that you carefully consider the following questions as you consider direct lending proposals. First, will there be adequate capital so that the loan program remain an entitlement under which all eligible students have access to loan capital?

Second, how do we prevent institutions from redlining students they consider risky borrowers since institutions are being held for high default rates; that is, there have been increasing numbers of institutions are being cut off from participation in the programs, will they deny loans to students who may think are likely to drop out and default? Will this end up denying first generation college students, students of color and low income students from access to loans and a postsecondary education? We have the same concerns about the administration's proposal for credit checks.

Third, if financial aid officers that direct lending institutions take on new overhead costs and thus require additional funding, will there be new costs passed on to the backs of students? Will direct lending really eliminate the need for origination fees and insurance premiums? And if there are savings, will they go into grant programs?

In conclusion, USSA recognized the importance of the Stafford loan program in opening up the doors of higher education. With the above changes, USSA believes that students will be better served by the loan program.

During this reauthorization we urge you to put into place default reducing and cost saving measures that improve institutional quality and students' access, rather than ones that punish current and future students for defaults and fraud of the past.

Thank you once again for this opportunity, and I'm happy to answer any questions you might have.

[The prepared statement of Selena Dong follows:]

USSA "Organizing and Advocating for Students Across the Country"

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JUNE 6, 1991

STATEMENT OF THE
UNITED STATES STUDENT ASSOCIATION
ON THE STAFFORD LOAN PROGRAM AND THE REAUTHORIZATION OF THE HIGHER EDUCATION ACT

BEFORE THE HOUSE SUBCOMMITTEE ON POSTSECONDARY EDUCATION

PRESENTED BY
SELENA DONG
LEGISLATIVE DIRECTOR

I would like to thank Chairman Ford and the subcommittee for this opportunity to testify. My name is Selena Dong and I am Legislative Director of the United States Student Association (USSA), the country's largest and oldest national student organization, representing more than 3.5 million students. USSA recognizes that the Stafford (formerly the Guaranteed Student) Loan program has enabled countless students to pursue a postsecondary education. However, our proposals for the Stafford Loan program are accompanied by our strong belief that a Pell Grant entitlement is a necessary prerequisite to making our loan programs work in the interests of current and potential postsecondary students, as well as our Nation.

First of all, USSA shares Congress' concern about the increasing costs of Stafford Loan defaults. However, we would like to dispel a few myths about why and when students default, and the role of institutions in reducing student loan defaults. First and foremost, we would like to point out that **the overall percentage of students defaulting on their loans "has remained roughly steady over the past 10 years (at about 10 percent of the dollars borrowed."**[1] Hence, even though total student volume has quadrupled in the last decade, a consistent 90 percent of students DO repay their loans.

Second, USSA is NOT suggesting that the 10 percent of loans that go into default are not significant or reason for us to carefully consider ways to improve the percentage of students who repay their loans. Hence we are very supportive of congressional, institutional, and postsecondary community efforts to decrease the number of defaults and to reduce fraud and abuse in the student loan system. We hear from too many students who fall through the cracks and end up defaulting on their loans, or who have been ripped off by fraudulent schools. **However, our efforts to curb abuse and achieve savings in the student loan program CANNOT be at the expense of students' access to higher education.** As this testimony will demonstrate, origination fees, difficult repayment schedules, delayed disbursement, inflexible treatment of students in cases of closed schools, and the cutting off of institutional eligibility for participation in the student loan program ultimately hurt students. Too often it is current and future students who must pay for the student loan defaults of the past. And too often what students must give up to pay this price is their educational opportunities.

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[1] Gladieux, Lawrence F. "The Student Loan Quandary" Change, May/June 1989.

In addition, we must make a careful distinction between fraudulent schools and those that may have higher than average default rates simply because they provide a crucial service: that is, they serve low-income populations that are less academically prepared than their more privileged counterparts. These schools should be applauded rather than presumed to be the source of blame for the Stafford Loan default problem. As we testified last Tuesday, a Pell Grant entitlement would decrease the amount of low-income students forced to take on huge loans to pay for their postsecondary education, increase the persistence rates of students, and thus significantly reduce the number of Stafford Loan defaults.

Third, there are many reasons why students default, including ones for which it is unfair to assign blame to the student. Half of Stafford Loan defaulters are dropouts from postsecondary programs. These people are not likely to have the job prospects or enhanced earning power that accompany a postsecondary degree or certificate, and thus face difficulty repaying their loans. Many student loan defaulters WANT to pay back their loans; they just CANNOT. Hence, we must strengthen our investment in the retention programs - including the TRIO Programs for Students from Disadvantaged Backgrounds - that enable students to stay in school and not become another default statistic.

In addition, many students are not adequately counseled on the seriousness of and responsibilities involved in taking on a loan. As one student at Mr. Hayes' field hearing testified, taking out a student loan was his first major financial decision ... a decision that he now regrets. When state and federal grants failed to cover his freshman year costs, he was told by his financial aid administrator that a $2,000 loan could easily and quickly be in his hands. He took out the loan, and when family difficulties required him to "stop out" temporarily, he did not know about grace periods, deferment options, or even that he was suppose to pay back his loan. Not surprisingly he has become another default statistic. And he finds it extremely frustrating that he cannot reverse his defaulter status - and again receive student financial assistance - until he pays off the loan entirely, something he just cannot afford to do so right now.

USSA thus supports efforts to improve students' awareness and understanding of the financial aid programs through a public advertising campaign on student aid, and through better training of high school counselors, as well as financial aid

administrators, on the complexities of the student aid system. This would help ensure that students have all the knowledge necessary to make good decisions and to be responsible and informed student loan borrowers.

USSA's proposals for the Stafford Loan program include a number of parts.

Origination Fees and Insurance Premiums

First of all, USSA feels strongly that **origination fees and insurance premiums should be eliminated.** Students apply for financial aid because they do not have a lot of money. How can we then expect them to pay application fees, origination fees and insurance premiums? Right now, students are often charged an application fee when they apply for financial aid. And since 1981, the Higher Education Act has authorized lenders to collect from Stafford Loan borrowers an **origination fee** equal to 5% of the loan's principal to be paid to the federal government in order to offset the costs of federal in-school subsidies and special allowance payments to lenders. In addition, Stafford Loan borrowers may be charged up to 3% of the loan principal as an **insurance premium** to defray guaranty agency default costs. In other words, under the current system, a student who is supposedly receiving a $2500 Stafford Loan is really receiving $2300, but must repay the loan as if he/she had received the full $2500.

There is currently no origination fee attached to the Supplemental Loans for Students or the PLUS programs, but SLS borrowers have to pay an insurance premium up to 3% of the loan principal.

Attachment #1 is an actual "Notice of Loan Guarantee and Disclosure Statement" of a Wisconsin student. You will notice that while he took out a $3,388 loan, he was charged a $60 insurance premium, or "guarantee fee", and a $169.40 origination fee. So he was given only $3,158.60 out of a $3,388 loan to cover his college costs ... but will eventually be expected to repay the entire $3,388 (plus interest of course). This is clearly unfair. Low-income students are the last people who should be taxed in such a way to save the federal government money.

Supplemental Loans for Students (SLS) and PLUS Loans for Parents

Second, USSA believes that the continuing support of a government-guaranteed and subsidized loan program is crucial to the opening of educational opportunity to all students. Millions of undergraduate, graduate and professional students at colleges, universities, community colleges, professional schools and vocational and trade schools have depended on Stafford Loans to access higher education.

Unfortunately, many students from hard-pressed working and middle-income families have been squeezed out of eligibility for the Stafford Loan program into taking on the more onerous **Supplemental Loans for Students (SLS) and/or PLUS loans for parents.** These loans have high and variable interest rates, and difficult repayment rules. Student and parent must begin repaying the loan within 60 days of disbursement (as if they are any richer after 2 months). Or if they defer repayment while the student is in school, the government does NOT subsidize the interest during the deferral. The interest starts accruing the day the loan is disbursed to the student or parent. USSA recommends the abolishment of the SLS and PLUS programs unless they become subsidized and more manageable in repayment.

Attachment #2 is an actual Repayment Addendum and Disclosure Statement from a lender to a SLS borrower, a student from Louisiana. It shows that after she makes repayments on her SLS loan of $4,000 over the next nine years, she will have had to repay $8,362. She will have to pay $8,362 for a $4,000 loan. It's crazy that poor people are expected to pay twice as much for their education! And this loan - among the other ones she has - will affect the rest of her life. She has already had to turn down a number of low-paying jobs in the public sector in favor of higher-paying ones that can pay her bills and her loan payments. She wishes now that she had received better counseling regarding her loan options; she says she would have found another way to pay for her education rather than take on this monster of a loan. I am not sure what she could have done differently; after all she was receiving many other kinds of financial assistance, working full-time and going to school full-time, and still had unmet need.

Likewise, a New Jersey student from a single parent household was not eligible for a Pell Grant. Her education will end up costing her a $4,000 in Perkins Loans, $16,000 in PLUS loans, and $15,000 in Stafford Loans. She is now a graduate with $20,000 worth of personal debt. When she turns down jobs that she wants to do but pay her too little to help her pay off these loans, she and her mother, saddled down with $12,000 worth of debt, wonder if her higher education was worth it.

Need Analysis: Home and Farm Equity

Third, to increase the Stafford Loan eligibility of hard-pressed students from working-class and middle-class families, USSA recommends **removing the use of home and farm equity in the Congressional Methodology needs analysis.** It is unfortunate that federal financial aid policy has taken a 180 degree turn so that the loans have become the largest source of aid to even the neediest students, while middle-income students have been squeezed out of the loan program designed for them.

Increased Loan Limits

Fourth, USSA recommends in addition to making Pell Grants an entitlement and investing more in Supplemental Educational Opportunity Grants (SEOG) that Congress **increase Stafford Loan limits for sophomores, juniors, seniors and graduate and professional students.** These increases of 33%, 25%, and 20% are necessary to make up for the affects of inflation, and to cover the skyrocketing costs of higher education, especially graduate and professional school. USSA is not recommending an increase in the Stafford loan limit for first-year students. Instead, we think that first-year students should receive additional Pell Grant money to cover their college costs and enable to persist to their second-year. After all, the first year is the most difficult year for student retention.

Less-than-half-time Students

Fifth, USSA strongly believes that **less-than-half-time students should be eligible for Stafford Loans.** Their current ineligibility for the largest loan program does not make sense in light of the changing demographics of our college campuses. We feel that this population's persistence and graduation rates would be significantly increased if they were made eligible for Pell Grants and Stafford Loans.

Grace Period

Sixth, USSA recommends **restoring the grace period to nine months instead of the current six months.** After graduation (or temporarily discontinuing school), a student may take many months to find a job and have the earning power to start repaying his or her loan. This is particularly true during these economic times. There have been many stories on the difficulties recent college graduates have had in finding jobs in their fields.

Repayment schedule

Seventh, USSA supports the **extension of the current ten-year repayment schedule to fifteen years.** This current repayment schedule can be extremely difficult for graduates, especially those who are in low-paying jobs and/or support dependents. For those with student loan debts in excess of $10,000, a graduated 15-year repayment schedule should be available. This change would cut down on the number of student loan defaults by those who intend to pay but cannot do so in a ten-year period. This kind of flexibility should be accompanied by increased publicity on the deferment and repayment options for student loan borrowers.

Delayed Disbursement

Eighth, USSA is extremely concerned about the **lateness with which students receive their loans -- whether it is a result of Congressional mandates for delayed disbursement or lenders' schedules.** Students depend on the prompt receipt of their loan money to pay for tuition, rent, child care, transportation, and so on. If they did not need the money promptly they would not have applied for it! Delayed disbursement is forcing some students to drop out of school since they cannot afford to stay in. Too many schools actually impose late fees on students whose late loan checks are not their fault. It's not like these students have extra money lying around to pay off these late fees. Other students are actually dropped from the classes they have registered for because they have not paid their tuition bills on time. It is also pretty hard to pursue your academic work if your loan check is late, which means you must pay your tuition bill late and so a hold is placed on your student identification card and you cannot access the computer facilities or check out library books. Delayed disbursements are an unnecessarily harsh response to the loan default problem; they punish current and future students for the defaults of the past, and endanger their ability to stay in school.

Hence, USSA recommends that this committee to consider repealing current mandated delayed disbursements, and rejecting proposals for additional ones. This includes:

- The 1990 Omnibus Reconciliation Act provision that imposed a 30-day delayed disbursement of student loans to all first-time borrowers;

- The 1989 reconciliation act provision that imposed a 30-day delayed disbursement of SLS loans to first-time borrowers;

- The administration's proposal to delay the disbursement of loan checks by 60 days to all students at institutions with default rates over 30%.

These delays are an extremely serious manner for students. In fact, the lateness with which they receive their loans - and the absence of adequate counseling about these delays - constitute one of the most often voiced complaints by our membership. In some cases these delays are life-threatening. One student from Maryland testified at a Senate field hearing on Reauthorization that her loan checks always come late. One fall she was forced to use her savings to pay off her tuition bill; this was money she had intended to use to renew her health insurance. She figured that a one or two-month lapse in her health insurance would be "no big deal." That is, until she found out that she had cervical cancer. With no health insurance and only part-time employment, she had to undergo a desperate search for a doctor who would operate on her. Eventually she borrowed money from friends to fly home and be operated on by a doctor there who was kind enough to reduce the costs and accept a payment plan. While she was technically not suppose to count on her loan money to pay off her health insurance, this delay in the delivery of loan check gave her no other choice.

Clearly student aid should be delivered in a timely manner. If Congress is not willing to do away with these mandated delayed disbursements, then USSA suggests that postsecondary institutions taking part in the student loan programs be prohibited from penalizing students for late loan checks that are not their fault. We are suggesting that legislative language be added to the Higher Education Act that prohibits institutions ...

> "from imposing late fees, dropping from enrollment, or any way penalizing students whose student loans have been approved and processed, and is being held either by the institution or bank for whatever reason and will arrive after the start of the quarter or semester. The students must be able to enjoy all the rights enjoyed by all other enrolled students, such as library and computer facilities access."

Inflexible Treatment of Student Loan Defaulters: Cases of Closed Schools

Ninth, USSA shares a concern that was brought up by Congressman Coleman at a hearing last week. We believe that **when determining who is a student loan defaulter that there must be some flexibility, especially in cases of fraudulent and/or closed schools.** We were very disturbed to learn what the response of the Department of Education was to a plea from a Florida state attorney, who had written to the Department regarding the case of a school that had forged the signatures of students on some loan checks. When the school closed down, these students who were already victims of a school that did not provide them with the training promised to them then became victims of the Department, which refused to forgive their loans. Yet these students were not even aware of loans being taken out in their name. While we understand the Department's belief that states play the important role of licensing and monitoring schools, we object to their firm stance that these students should be required to pay back these lo[illegible]nce again, innocent students are being forced to pay the price for the Department's desire to crack down on fraudulent trade schools. We believe that the savings from refusing to forgive these loans will be outweighed by the human and societal losses that will result from these people being denied a past and probably a future education.

Loan Forgiveness for Community Service

Tenth, there is no doubt that student loan borrowers' **post-graduation career and job choices** are increasingly dictated by economics rather than personal desires and goals. Congress has recognized this by enacting a long list of deferment and cancellation options for students going into specific low-paying fields and volunteer work. There has been much discussion regarding partial loan cancellation for students who go into low-paying community service jobs; Senator Bumpers has introduced legislation (S. 527) to this effect. While USSA supports the use of deferments and partial cancellations to allow students a full range of post-graduation options, we believe that a more comprehensive and cohesive solution is the adequate funding of student aid programs, including a Pell Grant entitlement, which would ensure that ALL students have this full range of options, rather than just those who go into a specific type of low-paying work or organization.

Simplification and Information-Dissemination

Eleventh, USSA also supports a number of proposals that have been put forth by the National Council of Higher Education Loan Programs (NCHELP) and the

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Student Loan Marketing Association that would **simplify the application and delivery process, and increase students' understanding of the student loan process and options.** Increased counseling for student loan borrowers, enhanced communication between the parties involved in student loans, timely notification regarding deferment eligibility - in addition to our recommendations above - would be effective steps to take in the effort to make the system more "user-friendly", reduce defaults, and ensure that students make choices that are best for them.

Proposals for Direct Lending

Lastly, USSA is very interested in the proposals regarding an **optional direct lending program**, especially that of the American Council on Education. We support the development of this idea for the following reasons:

- Simplification of the loan application, delivery, updating, and repayment processes. The current GSL structure of more than 13,000 lenders, over 50 guarantee agencies, and many secondary markets results in an overwhelming system of multiple applications, fees, paperwork and massive confusion for too many students. By contrast, the Perkins Loan program is far easier for students to understand and use. USSA believes that many defaults are the result of the complexity and confusion of this system that leaves too many students with too little information and no sense of who to go to for answers.
- The possible elimination of origination fees and insurance premiums.
- The possibility of substantial savings (a reduced need to pay the special allowance rate) that could be channeled into increased grant aid.
- Automatic loan consolidation.

However, as this committee looks into direct lending proposals, USSA asks that you carefully consider the following questions:

- Will there be adequate capital so that the loan program will remain an entitlement under which every student who is eligible for the program can get a loan?

- How do we prevent institutions from "red-lining" students they consider risky borrowers? Since institutions are being held responsible for high default rates (i.e. high default schools are being cut off from participation in student loan programs), will they deny loans to students whom they think are likely to drop out and default? Will this end up denying *first-generation college students, and students from low-income and ethnic minority backgrounds* access to loans and a postsecondary education? We have the same concern regarding the Administration's proposal for credit checks for student loan borrowers age 21 and older.

- If financial aid offices at direct lending institutions take on new overhead costs and thus require additional funding, will there be new costs passed on to students? Would direct lending really eliminate the need for origination fees and insurance premiums? If there are savings from restructuring the loan program, will they go to student aid programs?

- Will nontraditional students - older students, part-time students, and evening students - receive adequate services regarding loans if financial offices are only open during the day?

USSA looks forward to further discussing these issues as you consider direct lending proposals, and stands ready to be of assistance. We think that the direct lending could be a powerful way to ensure that student loans work in students' interests.

In conclusion, USSA recognizes the importance of the Stafford Loan program in opening up the doors of higher education. With the above structural changes, USSA believes that students would be even better served by the program. During this Reauthorization, we urge you to put into place default-reducing and cost-saving measures that improve institutional quality and students' access, rather than ones that punish current and future students for defaults and fraud of the past. As Congressman Coleman pointed out, the costs of a proposal for increased risk-sharing among states and institutions could easily be passed on to the backs of students in the form of additional origination fees. We applaud this foresight and look forward to working with the entire committee to make our loan programs the best possible.

Once again, thank you for this opportunity, and I am pleased to answer any questions you might have.

NOTICE OF LOAN GUARANTEE AND DISCLOSURE STATEMENT FOR A GUARANTEED STUDENT LOAN
LENDER USE ONLY: 002024312

ATTACHMENT #1

Lending Institution Name and Address

CITIBANK STUDENT LOAN BUSINESS
PO BOX 22944
ROCHESTER NY 14692

RESERVE ID SH- N-000000-01
LOAN PERIOD 05/15/91 THRU 08/18/91
LENGTH OF GRACE SIX FULL MONTHS
GRADUATION DATE 08/91
MATURITY DATE 03/01/92

[illegible] 326873 Date Produced 05/[illegible]4/91
Interest Rate 8.00 Date Guaranteed 05/23/91

School Name and Address 001444

GEORGE WASHINGTON UNIVERSITY
2121 I STREET, NORTHWEST
OFFICE OF FINANCIAL AID
WASHINGTON DC 20052

Social Security Number
Borrower Name and Address PHONE:

WI

[illegible] If any required installment payment has not reached the Lender within 10 days after its due date, the Lender may, if permitted by [illegible] you [illegible] charge at the maximum rate permitted. If a payment is late, you may be charged 6.00 % of the payment.

[illegible] the Lender including this loan is $3388.00 This amount includes only the Stafford Loan (formerly called the Guaranteed Student [illegible] and Consolidation Loans currently held by this lending institution. It does not include any amounts you may owe through other lending institutions [illegible] the amount you may owe through other loan programs.

[illegible]	[illegible]	Loan Amount	Less Guarantee Fee	Less Origination Fee	Amount of Loan Check	Pre-Paid Guarantee Fee
ENTIRE 0101	05/26/91	$ 3,388.00	$ 60.00	$169.40	$ 3,158.60	N/A

*** FLAG APPLICATION ***

IN ACCORDANCE WITH THE REQUIREMENTS OF FEDERAL LAW, THE ORIGINATION FEE FOR YOUR LOAN EQUALS 5.0% OF THE LOAN AMOUNT. BY CASHING YOUR STUDENT LOAN CHECK, YOU ARE AGREEING TO PAY THIS ORIGINATION FEE.

THE GUARANTEE FEE IS EQUAL TO 3.00 PERCENT ON THE LOAN AMOUNT OR $ 50.00, WHICHEVER IS LESS.

IF YOU NEED ADDITIONAL FINANCIAL AID, YOU OR YOUR PARENTS MAY BE ELIGIBLE UNDE USA FUNDS* PLUS (PARENT) LOAN PROGRAM. FOR AN APPLICATION KIT CALL 800-LOAN-US (NATIONWIDE).

THE APPLICABLE INTEREST RATE ON YOUR LOAN WILL BE 8% PER YEAR UNTIL THE END OF THE FOURTH YEAR OF REPAYMENT AND WILL BE 10% PER YEAR THEREAFTER. YOU MAY ALS RECEIVE REBATES OF INTEREST AS REQUIRED BY LAW. IF YOU HAVE OUTSTANDING GSL, SLS, PLUS OR CONSOLIDATED LOANS COVERING LOAN PERIODS WHICH BEGAN PRIOR TO JULY 1, 1988, CONTACT YOUR LENDER.

See Reverse Side)

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ATTACHMENT #2

REPAYMENT ADDENDUM AND DISCLOSURE STATEMENT DATE 04/29/91 612

SLS LOAN REVISED (BORROWER COPY)

0275-012-17-379744595-2

10 SOCIAL SECURITY NUMBER:

IN ACCORDANCE WITH THE REPAYMENT SECTION(S) OF THE STUDENT LOAN PROMISSORY NOTE(S) LISTED BELOW, FIRST NAT'L BANK COMMERCE, HOLDER, ADOPTS THIS REPAYMENT ADDENDUM AND DISCLOSURE STATEMENT AS AN AMENDMENT TO THE LISTED NOTE(S) AMENDING REPAYMENT PROVISIONS IN ACCORDANCE WITH THE REPAYMENT SCHEDULE BELOW. EXCEPT AS HEREIN AMENDED, THE TERMS, CONDITIONS AND PROVISIONS OF THESE NOTES(S) SHALL REMAIN UNCHANGED. THE ADOPTION OF THIS ADDENDUM DOES NOT DISCHARGE THE OBLIGATIONS OF ANY PARTY TO THE NOTE(S).

LOAN NUMBER	DATE OF DISBURSEMENT	DATE INTEREST BEGINS TO ACCRUE	INTEREST RATE	ESTIMATED UNPAID PRINCIPAL BALANCE ON REPAYMENT START DATE	ESTIMATED UNPAID INTEREST TO BE CAPITALIZED
01	03/29/89	03/29/89	11.490% **	$ 4,000.00	$ 1,002.25

** VARIABLE RATE LOANS (APPLIES TO SLS/PLUS LOANS ONLY). SEE YOUR PROMISSORY NOTE FOR METHOD OF CALCULATION.

TOTAL AMOUNT TO BE REPAID: E=ESTIMATE

TOTAL ESTIMATED UNPAID PRINCIPAL BALANCE ON REPAYMENT START DATE.	$ 4,000.00
TOTAL ESTIMATED UNPAID INTEREST TO BE CAPITALIZED.	$ 1,002.25
EQUALS: PRINCIPAL AMOUNT TO BE REPAID.	$ 5,002.25
ADD: INTEREST PAYABLE DURING REPAYMENT PERIOD.	$ 3,360.56
EQUALS: TOTAL AMOUNT TO BE REPAID.	$ 8,362.81

YOUR PROJECTED REPAYMENT SCHEDULE IS (PAYMENTS SHALL BE MADE IN MONTHLY INSTALLMENTS, DUE ON THE SAME DAY OF EACH MONTH, IN ACCORDANCE WITH THE FOLLOWING SCHEDULE):

117 PAYMENTS OF $ 71.00 BEGINNING 06/27/91
WITH A FINAL PAYMENT OF $ 55.81 DUE ON 03/27/01

PAYMENT OF INTEREST: THE AMOUNT OF THE REGULAR PAYMENT IS BASED UPON THE ASSUMPTION THAT ALL PAYMENTS WILL BE MADE ON THE SCHEDULED DUE DATES. THE TOTAL INTEREST PAYABLE DURING THE REPAYMENT PERIOD MAY BE MORE OR LESS THAN CONTEMPLATED BY THIS REPAYMENT SCHEDULE, DEPENDING UPON WHETHER YOU PAY EARLIER OR LATER THAN SCHEDULED. THE AMOUNT OF THE FINAL PAYMENT INDICATED WILL BE ADJUSTED UPWARD OR DOWNWARD TO REFLECT THE BALANCE DUE BASED UPON THE DATES THE PAYMENTS WERE ACTUALLY RECEIVED.

INTEREST DURING DEFERMENT WILL BE CAPITALIZED (ADDED TO THE PRINCIPAL AMOUNT OF THE LOAN(S)), IF PROVIDED FOR IN YOUR PROMISSORY NOTE, IN ACCORDANCE WITH APPLICABLE LAWS AND REGULATIONS OF THE GUARANTOR.

PREPAYMENT: YOU MAY, AT YOUR OPTION AND WITHOUT PENALTY, PREPAY ALL OR ANY PART OF THE PRINCIPAL ON THE LOAN(S) LISTED ABOVE AT ANY TIME.

LATE CHARGES: IF PERMITTED BY STATE LAW, THE LENDER MAY COLLECT A LATE CHARGE IF YOU FAIL TO PAY ALL OR PART OF A REQUIRED INSTALLMENT WITHIN 10 DAYS AFTER IT IS DUE OR TO PROVIDE WRITTEN EVIDENCE THAT VERIFIES ELIGIBILITY TO HAVE PAYMENT(S) DEFERRED. A LATE CHARGE MAY NOT EXCEED 6 CENTS FOR EACH DOLLAR OF EACH LATE INSTALLMENT.

COLLECTION CHARGES: YOU AND ANY COMAKER OR ENDORSER, IF APPLICABLE (REFER TO YOUR PROMISSORY NOTE), SHALL BE JOINTLY AND SEVERALLY LIABLE FOR ALL COSTS, INCLUDING, BUT NOT LIMITED TO, REASONABLE ATTORNEY'S FEES, COURT COSTS AND COLLECTION AGENCY FEES INCURRED THAT ARE NECESSARY FOR THE COLLECTION OF PAYMENTS NOT PAID WHEN DUE.

CONSOLIDATION/REFINANCING: A CONSOLIDATION LOAN PROGRAM IS AVAILABLE UNDER WHICH YOU MAY BE ABLE TO CONSOLIDATE LOANS THAT YOU RECEIVED UNDER THE STAFFORD (GSL) LOAN PROGRAM, SLS PROGRAM, PERKINS LOAN PROGRAM (FORMERLY THE NATIONAL DIRECT STUDENT LOAN PROGRAM), AND THE HEALTH PROFESSIONS STUDENT LOAN PROGRAM. CERTAIN PLUS, SLS, AND ALAS LOANS MAY BE REFINANCED TO COMBINE PAYMENTS OR OBTAIN A VARIABLE INTEREST RATE. CONTACT THE HOLDER(S) OF YOUR LOAN(S) OR YOUR GUARANTOR FOR MORE INFORMATION.

HOLDER: FIRST NAT'L BANK COMMERCE LID: 805147

SERVICER: FIRST WACHOVIA STUDENT FINANCIAL SERVICES INC.
P.O. BOX 3077 WINSTON-SALEM, NC 27102

ALL COMMUNICATIONS AND PAYMENTS MUST BE SENT TO THE SERVICER AT THE ABOVE ADDRESS UNLESS THE HOLDER NOTIFIES YOU OTHERWISE IN WRITING.

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Chairman **Ford**. Mr. William Banks.

Mr. **Banks**. Thank you, Mr. Chairman and members of the subcommittee. My name is William Banks, Vice President with Chemical Bank. Thank you for the opportunity to testify today on the Stafford student loan program. My testimony reflects the views of the Education Funding Committee of the Consumer Bankers Association.

Chemical Bank began making loans to students in New York State during the 1960s. We remain one of the five largest originators and holders of Stafford loans in the U.S. and are the second largest bank holder of loans. Last year we made over 50,000 loans to students and parents of students. This included Stafford, SLS, PLUS and consolidation loans.

Chemical currently holds over $900 million in guaranteed student loans. We hold every Stafford, SLS, PLUS and consolidation loan we make for the full life of the loan.

My testimony today reflects my belief that the Stafford loan program is built on a sound structure for providing capital to students interested in pursuing postsecondary education. That is not to say that improvements are not needed. Many improvements, however, have already been made, the impact of which is yet to be realized.

With additional changes, we believe the program can be strengthened as a remarkably successful means of leveraging over $12 billion per year in new private capital in support of education.

Mr. Chairman, lenders are well aware of the interest of this subcommittee in the Pell grant program. We share you commitment to strengthened Pell grants, both by expanding the maximum grant and by assuring that the maximum grants specified will be funded.

We hope to work with this subcommittee on achieving this goal while, at the same time, improving the Stafford student loan program to better meet the needs of students. A strengthened Pell grant program has the added benefit of reducing the borrowing needs of low income students.

In developing its reauthorization proposals, CBA has sought to identify areas where student services can be improved through enhanced simplification and standardization. CBA has put particular focus on Stafford loans and how this vitally important part of student aid can be made less complicated for students and less costly to the Federal Government.

CBA endorses proposals put forth by Representatives Lowey and Sawyer to make information about programs funded through the Higher Education Act more readily available to students and to provide specialized educational services for those students statistically most likely to drop out of school. Innovations of this kind are vital to the future economic health of the Nation. Details regarding the major CBA recommendations accompany this statement.

In summary, first, we propose simplification and standardization of all forms and procedures used in the program to the maximum extent possible. There is no reason why application deferment and other forms and processing procedures used in the Stafford loan program should differ from guarantor to guarantor.

These differences confuse students, negatively reflect the level of service they receive from lenders, make the life of the financial-aid administrator unnecessarily difficult and increase the administrative costs faced by lenders.

Mr. Chairman, we believe that legislating greater standardization and simplifying as many aspects of the program as possible will solve many of the problems described by schools which currently bear the administrative burden of dealing with multiple lenders and guarantors in the program.

Secondly, establish a loan program for middle income students. Rising college costs have made it increasingly difficult for students from middle income families to attend the institution of their choice. More assistance needs to be offered to these students, but at a lesser cost to the Federal Government, than is needed for those programs targeted to low income students.

CBA has endorsed the unsubsidized middle income loan program put forward by NCHELP. In H.R. 1117, Representative Roukema has proposed amendments to the needs analysis system that would also correct inequities which result when inaccessible nonliquid assets are considered in needs analysis processing.

Third, simplification of the application process, including procedures to allow for one-time submission of basic eligibility and need information. During a 4 year college career, a student may fill out four, eight, or even sixteen separate application forms, all asking identical questions. The system needs to be streamlined to allow for a single, one-time submission of data when updating only as necessary.

Fourth, promulgate regulations under negotiated rulemaking with representatives from the higher education community.

In conclusion, Mr. Chairman, I would again like to emphasize the commitment of lenders to provide a stable, reliable source of capital to students and to administer the program with the same degree of commitment we do our other consumer product areas.

During the past 25 years, the Stafford loan program has provided over $110 billion in capital to students in pursuit of postsecondary education. It represents a successful public/private partnership which, with modest changes, will work even more effectively in the future.

Thank you again for the opportunity to testify. I would be happy to respond to any questions you or other members of the subcommittee may have.

[The prepared statement of William E. Banks follows:]

CBA
CONSUMER BANKERS ASSOCIATION
The Association for Retail Banks and Thrift Institutions
1000 Wilson Boulevard, 30th Floor, Arlington, Virginia 22209-3908
Tel.: 703/276-1750 • Fax: 703/528-1290

STATEMENT OF

WILLIAM L. BANKS

CHEMICAL BANK

ON BEHALF OF

CONSUMER BANKERS ASSOCIATION

BEFORE THE

HOUSE SUBCOMMITTEE ON POSTSECONDARY EDUCATION

June 6, 1991

Mr. Chairman, Members of the Subcommittee on Postsecondary Education, my name is William L. Banks, Vice-President with Chemical Bank, New York. Thank you for the opportunity to testify today on the Stafford Student Loan Program. My testimony reflects the views of the Education Funding Committee of the Consumer Bankers Association (CBA).

Chemical Bank began making loans to students in New York State during the 1960's. We remain one of the five largest originators and holders of Stafford Loans in the U.S. and are the second largest Bank holder of loans. Last year we made over 50 thousand loans to students and parents of students. This included Stafford, SLS, PLUS and consolidation loans. Chemical currently holds over $900 million in Guaranteed Student Loans. We hold every Stafford, SLS, PLUS and consolidation loan we make for the full life of the loan.

My testimony today reflects my belief that the Stafford Loan Program is built on a sound structure for providing capital to students interested in pursuing postsecondary education. That is not to say that improvements are not needed. Many improvements, however, have already been made, the impact of which is yet to be realized. With additional changes, we believe the program can be strengthened as a remarkably successful means of leveraging over $12 billion per year in new private capital in support of education.

Mr. Chairman, lenders are well aware of the interest of this Subcommittee in the Pell Grant program. We share your commitment to strengthen Pell Grants, both by expanding the maximum grant and by assuring that the maximum grant specified will be funded. We hope to work with this Subcommittee on achieving this goal while at the same time improving the Stafford Student Loan Program to better meet student needs. A strengthened Pell Grant program has the added benefit of reducing the borrowing needs of low-income students.

In developing its reauthorization proposals, CBA has sought to identify areas where student services can be improved through enhanced simplification and standardization. CBA has put particular focus on Stafford Loans and how this vitally important part of student aid can be made less complicated for students and less costly to the federal government.

At Chemical Bank, we take a keen interest in working with high school counselors, parents and students about how to access federal financial aid programs. CBA endorses proposals put forth by Congresswoman Lowey and Congressman Sawyer to make information about programs funded through the Higher Education Act more readily available to students, and to provide specialized educational services for those students statistically most likely to drop out of school. Innovations of this kind are vital to the future economic health of the nation.

Details regarding the major CBA recommendations accompany this statement. In summary, we propose:

1. Restoration of the balance between grant and loan assistance. Students are clearly concerned that they are borrowing too much, too early in their academic careers. To the extent possible, Pell Grants should be increased and front-loaded to decrease student dependence on loans early in their academic program.

2. Implementation of a major public education campaign to assure early awareness of the availability of student aid. We believe early information encourages students to go to college who might otherwise assume, mistakenly, that this opportunity is out of their reach. A major public awareness program should be directed to prevent this lost opportunity. It is clear that more must be done to convince families from all socio-economic levels that higher education is important, achievable and financially possible.

3. Simplification and standardization of all forms and procedures used in the program to the maximum extent possible. There is no reason why application, deferment, and other forms and processing procedures used in the Stafford Loan Program should differ from guarantor to guarantor. These differences

confuse students, negatively reflect the level of service they receive from lenders, make the life of the financial aid administrator unnecessarily difficult, and increase the administrative costs faced by lenders. Specific recommendations include:

-- Clean up the deferment process. One major step forward would be the simplification and reduction in the number of deferments available, a position which has been proposed by CBA and other groups. In addition, in-school deferments should be valid until the student's anticipated graduation date. If a student drops out, the change will be captured by the student status change verification process. Any necessary adjustments to interest and special allowance will then be made by the lender.

-- Clean up the status change process. This issue has been raised by several higher education groups, and currently many students are negatively impacted by flaws in the process. CBA has some specific recommendations with respect to this process that could significantly benefit students.

Mr. Chairman, we believe that legislating greater standardization, and simplifying as many aspects of the program as possible will solve many of the problems described by schools which currently bear the administrative burden of dealing with multiple lenders and guarantors in the program.

4. Establishment of a loan program for middle-income students. Rising college costs have made it increasingly difficult for students from middle-income families to attend the institution of their choice. More assistance needs to be offered to these students, but at a lesser cost to the federal government than is needed for those programs targeted to low-income students. CBA has endorsed the unsubsidized middle-income loan program put forward by NCHELP. In H.R. 1117, Congresswoman Roukema has proposed amendments to the needs analysis system that would also correct inequities which result when inaccessible, non-liquid assets are considered in need analysis processing. Congresswoman Roukema recommends other refinements which CBA endorses.

5. Simplification of the application process, including procedures to allow for the one-time submission of basic eligibility and need information. During a four-year college career, a student may fill out four, eight, or even sixteen separate application forms, all asking identical questions. The system needs to be streamlined to allow for a single, one-time submission of data, with updating only as necessary.

While CBA believes that it is appropriate to create a process through which data is collected a single time and used for multiple purposes, we also believe it would be inappropriate to combine the student loan application process with loan eligibility determination. A student should apply for a loan only after his/her eligibility for all forms of aid is determined. The promissory note can and must be signed separately to assure that all applicants are fully aware of their loan obligations.

6. Promulgate regulations under negotiated rulemaking with representatives from the higher education community.

7. Reduce differences between the requirements for repayment of SLS, PLUS and Stafford Loans to the maximum extent possible. One major recommendation in this area is elimination of the current 8/10 interest rate structure. CBA recommends that all loans currently subject to this provision be modified to remain at 8 percent and that all new loans be made at a variable rate, subject to a cap of 10 percent.

8. Eliminate unnecessary or extraneous program requirements and provisions, such as certification of registration for selective service. Student assistance programs should be as simple as possible. Any requirements not directly related to reducing defaults or assuring accountability need to be struck from the statute.

In addition to these recommendations, CBA has the following comments to present:

Concerns About the Strength of the Guaranty Agency System

The collapse of the Higher Education Assistance Foundation (HEAF) has been very well publicized. Lenders welcomed the leadership of the Department in assuring that outstanding HEAF guarantees would be honored. Lender concerns about the guaranty agency system as a whole, however, continue.

CBA welcomes recent Department of Education initiatives to gather data on the financial condition of guaranty agencies. We believe that Congress should provide guidance for the Department regarding steps to be taken if another agency faces financial difficulty. If a problem does develop, CBA believes that a resolution can be reached at minimal or no cost to the government through the use of advances to ride out cash-flow problems, or through mergers.

Department of Education Efforts to Curb Fraud and Abuse

CBA has followed with interest the recent announcements of major personnel changes at the Department of Education. Lenders are pleased that the Department has decided to initiate a substantial reorganization of the Office of Student Financial Assistance designed to effectuate better management and business practices. Last month, a group of lenders on the CBA Education

Funding Committee had an opportunity to meet with Michael Farrell, the new Deputy Assistant Secretary for Student Financial Assistance. We were very impressed with his interest in taking full advantage of modern data processing to improve management of the program.

We expect, Mr. Chairman, the new efforts at the Department of Education will complement those of lenders and guaranty agencies, to continue to reduce student loan defaults. We have indicated our willingness to help the Department on its efforts in this area.

The report released by Senator Nunn, following a two-year staff investigation, puts additional emphasis on the need for improved oversight and program management by ED. It is important to remember, however, that all the alleged fraud and abuse reviewed by the Nunn Subcommittee staff had, in fact, been uncovered and reported by participating guarantors in the Guaranteed Student Loan program. That indicates to many lenders that current practices do uncover fraud where it exists and result in appropriate punitive measures.

In conclusion, Mr. Chairman, I would again like to emphasize the commitment of lenders to provide a stable, reliable source of capital to students and to administer the program with the same degree of commitment we do our other consumer product areas.

During the past 25 years, the Stafford Loan Program has provided over $110 billion in capital to students in pursuit of postsecondary education. It represents a successful public-private partnership which, with modest changes, will work even more effectively in the future.

Thank you again for the opportunity to testify. I would be happy to respond to any questions you or other Members of the Subcommittee may have.

(105A699)

CBA REAUTHORIZATION PROPOSALS

The Consumer Bankers Association (CBA) believes that the reauthorization of the Higher Education Act should focus on the important social objectives of the program. In the last several years, rising education costs and inadequate growth in Pell Grant funding have led to increasing numbers of low-income students relying on student loans rather than grants to attend school. A failure to correct this trend will result in the further erosion of educational opportunity and lead directly to a decrease in access for students with the greatest economic need. The result will be a decline in America's ability to compete with other nations. Therefore, CBA endorses the efforts of Senator Pell (D-RI) and Representative Ford (D-MI) to increase grant assistance through vital expansion of the Pell Grant program.

The Guaranteed Student Loan programs represent a dramatically successful public - private partnership designed to achieve a valued social goal. In order to preserve and enhance that partnership, CBA has identified eight legislative priorities for the pending reauthorization of the Higher Education Act of 1965, as amended:

1. Simplified administration of the program through the use of modern data processing. CBA strongly endorses the elimination of unnecessary paperwork in the Guaranteed Student Loan programs. Record-keeping and loan administration practices in the student loan industry have fallen behind standards generally applicable to the consumer loan industry. Methods of record retention including microfilm, microfiche, laser disc, computer disc, and image optics should be utilized by the Department of Education to eliminate the storage of paper record-keeping beyond the loan application and the promissory note. Regulations issued by the Department of Education should accomplish the following:

- simplify all aspects of the student loan process including application, disbursement and origination;
- improve communication between lenders and guarantors by requiring the use of uniform reporting documents (this would also enhance borrower understanding of their loan obligation);
- simplify fulfillment of institutional responsibilities under this part by institutions of higher education; and
- improve the administration and oversight of the program by the U.S. Department of Education.

2. Simplification of borrower deferments. Under current law, eleven separate deferment categories allow borrowers to defer loan repayment. The proliferation of deferments has increased the complexity of program administration and has proven to be confusing to borrowers. Congressional intent in instituting deferments was to recognize the legitimate need for financial relief for borrowers in certain circumstances. CBA recommends the elimination of all deferment categories except the time periods during which a borrower is enrolled as a full-time student; and documented instances of economic hardship, such as unemployment or total disability. Lender use of forbearance allows all other borrower circumstances to be fairly and appropriately considered.

3. Due diligence procedures. Major lenders and servicers are in agreement that the due diligence regulations are too rigid and result in a higher priority being placed on maintaining compliance with the regulations than on loan collection. The Department of Education acknowledged the problems caused by the regulated standards currently in effect and recommended revisions to the thirty-day "bucket" system in the NPRM for the 1986 Higher Education Act Reauthorization in November, 1990.

It is CBA's view that the collection practices of a lender should be measured and taken into consideration when claims are approved or denied for payment. By establishing a tolerance rate for errors, lenders could concentrate on enhanced loan collection efforts rather than lock-step compliance with required letters and phone contacts which may or may not contribute to a borrowers repayment of the debt.

By imposing a percentage guideline for compliance, any lender who maintains a pre-determined performance rate standard (for example, 95 percent) on completion of mandatory due diligence steps would be assured full payment of insurance, interest and special allowance on loans made. This compliance would be monitored on a annual basis during the mandatory audit of a lender's portfolio. The audit would be paid for by the lender, monitored by the Department of Education, and performed by an independent third party auditor. Parameters of the audit, as defined by the Department, would follow standard accounting practices and would include a defined statistical sampling technique upon which a lender's performance would be measured. The performance measurement derived from the audit would be used by all guaranty agencies with whom the lender has participation agreements to determine how claims were to be paid. Lenders whose samples are found to be above the standard would be reviewed for proper monetary and technical data. Failure to maintain compliance at or above the defined standard would result in a full review of each file for the given time period and the assessment of prescribed penalties. Without the threat of

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inordinate penalties for inconsequential regulatory violations, the lending community would attempt collection innovations which emphasize the true spirit, rather than the exact letter of the law.

4. Procedures for handling insolvency of a guaranty agency. CBA believes that the statute should require guaranty agencies to operate on a sound actuarial basis. Furthermore, the statute should define steps to be taken by the Secretary of Education in the event of a guaranty agency solvency. In light of the recent collapse of the Higher Education Assistance Foundation, interest in these proposals has increased among the Congress and the Administration. Therefore, CBA recommends that the Act should require the Secretary of Education to do the following:

1. Periodically re-evaluate the solvency of all guaranty agencies.

2. Identify agencies which fall below specified federal standards relating to reserve ratio and/or other indicators of administrative and financial viability and require such agencies to: (A) operate under a guarantee management plan approved by the Secretary, (B) if appropriate, overcome a short-term cash flow problem through the receipt of additional repayable advances, (C) merge their operations with a stronger agency, or (D) terminate their operations and assign responsibilities for outstanding guarantees to the Secretary. After consultation with lenders, it would be the Secretary's prerogative to transfer such guarantees to a solvent agency.

3. Require the Department to publish the results of an annual survey of guaranty agencies to facilitate lender evaluations of agencies.

5. Use of negotiated rulemaking procedures to promulgate Title IV regulations. A recent GAO briefing report verified that the Department of Education rarely complies with the statutory requirement that regulations be promulgated within 240 days of legislative enactment. The regulations necessitated by the passage of the 1986 reauthorization of the Higher Education Act are not yet finalized; the NPRM did not appear in the Federal Register until November, 1990. Given the significant liabilities imposed on lenders, secondary markets and guaranty agencies for failure to properly administer the GSL program, the issuance of clear and timely guidance about legislated program changes is imperative.

The complexity of the GSL program is such that the Department of Education and the higher education community stand to benefit from early and direct communication about these mandated regulations. Early consultation can serve to educate the community and sensitize the Department to potential problems regarding implementation. For these reasons, CBA supports the use of regional meetings and negotiated rulemaking procedures in the development of regulations to govern the implementation of the reauthorization of the Higher Education Act, as was required, with certain modifications, in recent reauthorizations of the Elementary and Secondary Education Act and the Vocational and Adult Education Act. The use of negotiated rulemaking to promulgate regulations governing the implementation of Title IV should in no way be seen as a substitute for the useful and ongoing communication and issuance of Dear Colleagues which the Department presently undertakes with the higher education community.

6. Insurance to lenders. CBA believes that the requirement that guarantors offer 100 percent insurance to lenders as a condition for insurance program agreements with the Secretary is critical to maintaining open access to loans for all borrowers. The program already involves significant loss to lenders. Even with a 100 percent guarantee, lenders face significant losses because of strict due diligence penalties; and penalties resulting from retroactive regulatory changes that affect pre-existing loan agreements. Lender profitability has been reduced (GAO/HRD 90-130) and lender participation in the program has diminished as a direct result of this increased financial risk.

In the past, lender risk sharing has been put forth as a means of default reduction. There are preferable means of achieving this legitimate goal. CBA has proposed, for example, that lenders be given additional flexibility in fashioning collections procedures. It should also be noted that Congress has enacted numerous bills and amendments aimed at reducing GSL defaults. Remaining default reduction options such as stricter school cutoff rates or co-signer requirements will only serve to reduce access to loans for those potential borrowers most in need of financial assistance in order to pursue higher education.

7. Special Allowance. The special allowance paid to lender participants in the GSL programs is calculated by adding 3.25 percent to the 91-day treasury bill rate. The 1989 CBA Student Lending Survey found that the return earned by lenders in the GSL program was typically less than that earned on other consumer loan products. As the cost of funds and operational costs associated with the student loan business continue to increase, financial managers at lending institutions will revaluate their level of participation in the program. In order to maintain open access to loans for all eligible borrowers, the current special allowance calculation should be preserved. Additionally, if Congress determines that high-risk borrowers should continue to have access to GSLs, enactment of a higher special allowance to increase the return to lenders on loans made to such student borrowers should be considered.

8. Loans for middle-income students currently ineligible for guaranteed student loans. Students determined to be ineligible to borrow under congressional methodology remain eligible for unsubsidized Guaranteed Student loans. Because these loans are unsubsidized and offered at 8 percent, they are made by very few lenders. The Supplemental Loans for Students program (SLS) makes unsubsidized, guaranteed loans available to independent students and, in special circumstances, dependent borrowers, but many middle income students who need financial aid remain unserved.

CBA endorses a proposal put forth by NCHELP to expand loan access to guaranteed but unsubsidized loans to all eligible students. Under the NCHELP plan, only those students showing financial need would continue to be entitled to in-school interest benefits through subsidized Stafford loans. Unsubsidized loans would be available to those not qualifying for full subsidized Stafford loans. Interest on the unsubsidized loans that accrues during in-school, grace, and deferment periods would be paid either quarterly or capitalized, as agreed upon by the lender and the borrowers. Borrowers would pay a 5 percent reinsurance premium to offset the costs associated with defaults. The NCHELP proposal does not contain a specific proposal for an interest rate on unsubsidized loans. It is assumed that a rate would be set to eliminate any special allowance in all but extraordinary circumstances.

105/B/9

Mr. HAYES. [presiding] Thank you. Mr. Donovan.

Mr. DONOVAN. Mr. Chairman and members of the committee, my name is Carl Donovan. I'm President of the Northwest Education Loan Association, the designated guaranty agency for the State of Washington, and currently President of the National Council on Higher Education Loan Programs, acronymed NCHELP.

NCHELP membership is comprised of guaranty agencies and secondary markets, plus most of the major lenders and other organizations involved in the delivery of GSLs.

NCHELP published its position paper on reauthorization last summer, following over 2 years of development. I am submitting for the record the full text of NCHELP's proposals.

On three previous occasions before this subcommittee, representatives of NCHELP have commented on portions of the reauthorization paper. In May, the subcommittee heard testimony on our proposals for simplifying deferments and strengthening the school eligibility and default management processes.

Last Tuesday, the subcommittee heard our proposal to increase Pell grant eligibility and decrease loan eligibility during the early stages of a student's program of study.

All of these proposals, in combination with additional recommendations I will review today, comprise most of NCHELP's reauthorization package.

The 1986 amendments imposed a financial need test on all Stafford loan borrowers. As a result, many students from middle income families became ineligible for subsidized Stafford loans. NCHELP proposes that an unsubsidized Stafford loan program be created to aid these students. It would be identical to the existing subsidized program in all of its terms and conditions, with the single exception that in-school interest for middle income borrowers would not be subsidized by the Federal Government.

A borrower could fill out a single application for both a subsidized and an unsubsidized loan, requesting up to the maximum allowable by law, independent of the amount of expected family contribution or other aid received. If you showed need for a portion of the amount, you could receive that portion on a subsidized basis and the remainder on an unsubsidized basis.

NCHELP recommends that the interest rate for new borrowers in both the subsidized and unsubsidized Stafford loan programs be set at market rate, as currently calculated for SLS and PLUS loans, with a ceiling of 10 percent. This would eliminate the Federal interest subsidy during repayment, except under high interest rate conditions.

In addition, we urge the subcommittee to eliminate the split interest rates on current loans, converting those borrowers to a flat 8 percent rate instead.

The 1986 amendment set a rate to the student of 8 percent for the first 4 years of repayment, with an increase to 10 percent thereafter. In addition, they called for a cumbersome windfall repayment provision to assure that the rate to the borrower does not exceed market. This action has proved a nightmare to lenders and servicers alike. It also serves borrowers poorly, since lenders are unable to consolidate a student's debt in repayment if his loans are at different rates at the same time.

NCHELP has several proposals on loan limits reflecting its belief that loans should be minimized during the early stages of a student's program of study and that additional loan capital is needed to finance the rapidly increasing costs of upper division and graduate education.

We propose the following annual loan limits. For Stafford loans, undergraduate students, first year students, we propose keeping at the current level of $2,625 a year. This assumes a significant increase in Pell grant eligibility, however, to cover additional costs.

For the second year, we propose an increase from $2,625 to $4,000 a year. This assumes no material increase in Pell grant eligibility for second year students. For third, fourth and fifth year students, we propose that the loan limits be increased from the current $4,000 to $6,000 a year.

Now, our proposals for the first and second year could be reduced, depending on the extent to which Congress is able to achieve a front loading of grant assistance. And we would encourage that.

For graduate students, we propose an increase from the current $7,500 to $10,000 a year, and then in 1993, up to $12,000.

For SLS loans, our proposals assume a significant increase in Pell grant eligibility for lower division students and the authorization of an unsubsidized Stafford loan program, which takes pressure off the SLS program.

In that regard, then, for undergraduate students, we propose eliminating them from the SLS program. Second year students, we propose a decrease in the maximum from the current $4,000 to $2,000 and for third, fourth and fifth year, maintaining the current level of $4,000. For graduate students—we do propose an increase for graduate students since they would not receive the relief earlier indicated—from $4,000 to $10,000 a year.

For PLUS loans, we are proposing an increase from $4,000 to $10,000 a year. Now, again, PLUS loans are made, of course, to families. And we do propose a good credit checks be a requirement for those particular loans.

This completes my prepared testimony, Mr. Chairman. I'd be happy to answer any questions.

[The prepared statement of Carl Donovan follows:]

STATEMENT OF CARL C. DONOVAN

PRESIDENT, NORTHWEST EDUCATION LOAN ASSOCIATION

AND

PRESIDENT, NATIONAL COUNCIL OF HIGHER EDUCATION LOAN PROGRAMS

BEFORE THE

SUBCOMMITTEE ON POSTSECONDARY EDUCATION

HOUSE COMMITTEE ON EDUCATION AND LABOR

June 6, 1991

Mr. Chairman and Members of the Subcommittee. My name is Carl Donovan, and I am President of the Northwest Education Loan Association and current President of the National Council of Higher Education Loan Programs (NCHELP). The Council is an association of organizations and agencies involved in the administration of the Guaranteed Student Loan Program. Voting Membership is comprised of almost all of the State and private nonprofit guaranty agencies, secondary markets, and direct lenders. Associate Members include most of the major lenders, third-party servicers, collectors, Sallie Mae, and other organizations involved with the GSL Program. In essence, if the student is viewed as the ultimate consumer of Guaranteed Student Loans, NCHELP represents the providers of such loans.

We welcome the opportunity to appear before you today, as NCHELP shares your conviction, Mr. Chairman, that this reauthorization of the Higher Education Act may well prove to be the most important since the law's enactment in 1965 and the adoption of the Pell Grant Program in 1972. After all, most of the Federal student aid programs have been on the books more than 25 years. It is time that they be given a thorough review, with a eye toward their simplification and coordination, the better to meet the needs of today's students.

NCHELP has been working on development of its reauthorization proposals for more than two years. Today I would like to share with the Subcommittee the highlights of those recommendations. I am submitting the full paper containing the Council's proposals for the record.

The NCHELP reauthorization proposals are designed to implement six basic principles:

- **The foundation of financial assistance to low-income students should be grant aid.**
- **Access to postsecondary education must remain a national priority and federal student assistance programs should promote educational effectiveness as well as educational opportunity.**
- **The concepts underlying the Guaranteed Student Loan Program are fundamentally sound; the Program is essential to the financing of postsecondary education and to promoting educational choice.**
- **The Guaranteed Student Loan Program must be fiscally sound, responsive, and flexible.**
- **The administration and financing of the Guaranteed Student Loan Program represent a successful decentralized partnership among guaranty agencies, secondary markets, commercial lenders, servicers, institutions of postsecondary education, and the Federal government.**
- **Stability and continuity are essential to the continued success of the Guaranteed Student Loan Program and contractual agreements among participants must not be abrogated.**

While it may sound unusual for an organization primarily concerned with student loans to urge a redress of the current grant/loan imbalance, NCHELP is extremely concerned that budget pressures and the absence of an entitlement for the Pell Grant

Program have conspired to force students to borrow inappropriately high amounts in order to be able to attend postsecondary education programs. We believe that this reauthorization must address this problem, as the Subcommittee creates student aid programs in the 90's.

As the Subcommittee heard in testimony by Larry Matejka of the Illinois Student Assistance Commission on Tuesday, NCHELP proposes to address the grant/loan imbalance by concentrating Pell Grant funds on the beginning of a student's higher education career, with loans serving only a supplemental function, if any, during this time. Then, as the student's education continues, his loan eligibility would be substantially increased, and his Pell Grant eligibility reduced. It is NCHELP's hope that by coordinating the programs, Pell Grants can be converted to entitlements through merger with GSL's entitlement.

While NCHELP is concerned that federal student aid programs continue their basic mission of providing access to postsecondary education, we believe that it is essential that such access be to *quality* education. The Subcommittee has taken significant actions over the past several years, with strong NCHELP support, to assure that "bad schools" are eliminated from the GSL Program. But it is better for students and taxpayers if "bad schools" are not allowed into the Program in the first place.

NCHELP proposes strengthening the Secretary's authority to keep out institutions which are marginal, either educationally or financially, by changes in the current eligibility rules. Existing law makes an institution eligible if it is accredited by an accrediting agency recognized by the Secretary and licensed by the State in which it is located. While

Secretary Alexander has already taken administrative steps to tighten up his recognition of accrediting agencies, NCHELP proposes that the law be amended to give him specific authority to set standards for accrediting agencies to meet in their consumer protection requirements. Similarly, while the Secretary may not have a constitutional right to dictate State licensing standards, NCHELP believes that he should be given statutory authority to set minimum standards relating to educational outcomes and consumer protection requirements which State licensure must meet *in order to qualify an institution for participation in Federal student financial aid programs*.

All participating educational institutions should be required to demonstrate financial and administrative competency and integrity before participating in Federal student aid programs and as a condition of continued eligibility. NCHELP recommends that any new institution desiring to participate in the GSL Program be required to establish a Default Management Program for the first two years of its participation. Any institution which changes ownership or becomes a branch should also be subject to a Default Management Program for two years after change of ownership or status. In addition, guaranty agencies should have authority to regulate loan volume of such institutions.

Other institutional eligibility rules also need to be tightened. Under existing law, students in programs of less than 600 clock hours are only eligible for Guaranteed Student Loans. These are exactly the students who should *not* be borrowing. A course of only a few weeks length usually trains a student for a minimum wage job, certainly not an income level which allows for loan repayment. While students in extremely short courses may need some sort of Federal assistance, we urge that it not be loans, and that the definition of an eligible course for GSL be made the same as the definition currently applicable to Pell Grants and campus-based programs.

Similarly, NCHELP urges that correspondence education be made ineligible for Guaranteed Student Loans. Under the Department's interpretation of current law, if any course offering of a correspondence school has a residential component, students in all of the courses offered by that school are entitled to borrow. Correspondence education is almost impossible to monitor -- how does a lender know when a borrower has dropped out? It should be eliminated from GSL eligibility.

Current law requires that, *if an institution advertises job placement rates*, it must disclose to prospective students the data upon which such claims are based. NCHELP believes that this disclosure comes too late in the process to have a significant impact on a student's choice. Therefore NCHELP recommends that *if an institution advertises*, it must include relevant default, salary, and job placement information in its ads.

One of the major changes in the Guaranteed Student Loan Program made by the 1986 Amendments was the imposition of a needs test on all borrowers. As a result, many students from middle-income families were eliminated from eligibility for subsidized Stafford loans. However, as the Subcommittee is aware, college costs are increasing annually, and middle-income families are finding it exceptionally difficult to finance college expenses. While alternative loan programs have burgeoned, they are unable to meet the needs of families across the country.

Therefore, NCHELP proposes that an unsubsidized Stafford Loan Program be created to aid students from middle-income families. It would be similar to the existing subsidized program in all of its terms and conditions, with the single exception that in-school interest for middle-income borrowers would not be subsidized by the Federal government. Instead, such interest would be paid by the borrower or added to the principal amount borrowed no more frequently than quarterly. No Origination Fee would be collected; however, borrowers would pay a 5% reinsurance premium to cover default costs and Special Allowance payments, if any were required. As NCHELP envisions the unsubsidized Stafford Loan Program, it would not necessitate any new forms or applications. A borrower could fill out a single document encompassing both the subsidized and unsubsidized programs; if he showed need for a portion of the amount, he could receive that portion on a subsidized basis and the remainder on an unsubsidized basis.

NCHELP recommends that the interest rate for new borrowers in both the subsidized and unsubsidized Stafford Loan Programs be set at market rate, as currently calculated for SLS and PLUS loans, with the ceiling to the borrower set at 10%. The 1986 Amendments set a split rate of 8% for the first four years or repayment, with an increase to 10% thereafter, plus a cumbersome "windfall" provision to assure that lenders were not unfairly enriched. This action has proved a nightmare to lenders and servicers alike. It also serves borrowers poorly, as lenders are unable to consolidate their indebtedness administratively if their loans are at different rates at the same time. We urge the Subcommittee to eliminate all 8/10% split loans and repeal the "windfall" provision, converting those borrowers to a flat 8% rate. Since all new borrowers would pay a rate reflecting recent Treasury bill rates, no "windfall" would be possible.

Similarly, NCHELP urges that all new borrower be given only three deferments: in-school, unemployment, and temporary, total disability. These three categories, plus liberal lender forbearance, can cover all of the situations currently detailed in 13 specific deferments, all with their special rules, regulations, certifications, and complications. Students are totally confused by the current panoply of deferments and often fail to seek deferments for which they are eligible. For example, a lender is able to back-date an unemployment deferment only 3 months, under current regulations, and must require paperwork documenting continuing unemployment every three months thereafter. If an unemployed borrower doesn't realize that he is eligible for a deferment until 4 or 5 months after he becomes unemployed, he may already be inextricably caught in the web of delinquency and default. Simplification of deferments to an easily-understandable number would assure that borrowers get the relief from loan repayment that Congress intended.

The Guaranteed Student Loan Program is currently operating under regulations designed to implement the Education Amendments of 1980, regulations which became final *after the enactment of the Education Amendments of 1986*. Regulations to implement the 1986 Amendments were promulgated as a Notice of Proposed Rulemaking late last fall, and the NPRM did not include any of the provisions adopted in the 1989 and 1990 Budget Reconciliation Acts. NCHELP believes that it is unconscionable that a complicated program which makes available approximately $12 Billion per year to student and parent borrowers should not have up-to-date, publicly aired regulations. For this reason, we urge you to apply the Negotiated Rulemaking process you have already implemented for the Chapter 1 and Carl D. Perkins Vocational and Applied Technology Education Act programs to the Guaranteed Student Loan Program.

The great bulk of the NCHELP reauthorization paper was adopted by the Council's Board of Directors last July, just before the collapse of the Higher Education Assistance Foundation. That collapse triggered concern about guaranty agency fiscal strength and stability. Since the current law conditions agency financing on loan volume, there was additional concern that the front-loading of Pell Grants, as proposed by NCHELP, might result in a substantially reduced loan volume, thereby endangering the fiscal health of additional agencies. I therefore appointed an NCHELP Task Force on Guaranty Agency Financing, to develop proposals to assure guaranty agency financial stability if the size of the loan program were constricted as a result of Congressional action to redress the current grant/loan imbalance. We will share these proposals with the Subcommittee as soon as they are adopted by the Council.

Similarly, when NCHELP proposed Lender-of-Last-Resort language to the Congress in 1985, it was assumed that any loan access problems would be, as they had historically been, regional in nature. However, today's emphasis on unacceptable default rates raises the specter of lack of access for high-risk borrowers only. The situation is potentially exacerbated by proposals such as that of the Administration that would impose lender risk-sharing at a cohort default level of 20%, significantly lower than the 35% cut-off level adopted by the Congress in the 1990 Reconciliation Act. NCHELP has formed a joint task force with the Consumer Bankers Association and Sallie Mae to attempt to devise an economically feasible solution to this potential problem, which we will share with the Subcommittee once it is developed.

Finally, NCHELP is actively involved in simplifying the program for the student borrower in every way possible. All NCHELP Committees are analyzing public communications within their areas, with a eye to making recommendations to the Board on which forms and procedures we can encourage participants to standardize. Similarly, a Task Force has been working with the Department of Education to assure that all GSL application questions are included in the free Federal student aid application for the 1992-93 academic year. If we are successful, we will simplify the student application process while fulfilling the statutory requirement of a separate, identifiable GSL application with an application (possibly incorporating the promissory note) which only asks additional information required for collection, such as driver's license number and references. We are confident that these steps will make the GSL Program even more "user friendly," without encouraging students to borrow unnecessarily.

As I am sure you realize, the Subcommittee has an immense task ahead of it in reauthorizing the Higher Education Act. NCHELP appreciates the opportunity to appear before you today to share our recommendations. We look forward to working closely with you and your staff as the process continues.

I would be happy to answer any questions you might have.

Mr. HAYES. Thank you very much. I'm sorry to advise you that we've just been summoned to vote, which is part of our responsibility here. So we're half way home, at least; we've finished four votes. We'll take a 10 minute break while we go vote, if you don't mind. Thank you very much.

[Recess.]

Chairman FORD. Mr. Hough.

Mr. HOUGH. Thank you, Mr. Chairman. I am Lawrence Hough, President and Chief Executive Officer of Sallie Mae. I'm very pleased to have this chance to speak to several important issues concerning the guaranteed student loan programs.

Let me begin by briefly bringing you and the other members of this committee up to date on the role of Sallie Mae in supporting postsecondary education. We have provided support for four out of every ten dollars of guaranteed student loans outstanding today through our purchases in the secondary market and our financing of supporting lenders.

In addition, using the authority granted during the last reauthorization, Sallie Mae has initiated a successful program of facilities financing for educational institutions that has financed or supported financing for 121 institutions at a total dollar amount of $1.6 billion.

Our review today of the Stafford program should start acknowledging the successes of this Federal effort to provide student assistance over the past quarter century. However, the Stafford programs' past high level of effectiveness in fulfilling access goals is diminishing. And without program change, I believe it will fall short of meeting the challenges of this decade and the next.

These challenges are, indeed, enormous. Continuous escalation of college costs is now a well established reality. In the school year 1997-98, although the number of students at colleges and universities will remain virtually unchanged from today's level, their families will need an incredible $50 billion more in resources than they did this past fall.

While much of this amount will come from the natural growth in family income, a very substantial amount will only be met through various financial aid programs.

To address the challenges of insuring broad access and maintaining the flows of loan capital, we need to evaluate more carefully the difference in need and outcome of students and their families and tailor our existing framework of assistance to reflect these new circumstances.

Sallie Mae has begun such a review and has the following observations and suggestions. Increasing numbers of nontraditional adult students seeking to be retrained are finding little support from existing programs. We must do better to support the critical needs for manpower development.

The present guaranteed student loan program is also poorly suited to the special challenges of extending credit to students from families with the lowest annual income. If educational quality problems surrounding their quest for more education can be solved, then a loan program supplement to the Pell grant with the potential for repayment terms which provide for yearly income related cancellation could serve these students more effectively.

Middle income families also need more help in meeting college costs. Present Stafford, SLS and PLUS programs will fall short of meeting their needs as resource requirements soar to the levels I cited earlier. For this group, we suggest a program through which families would be encouraged to save for college and would be rewarded by access to partially subsidized guaranteed loans.

We believe that by making savings a prerequisite for receiving low interest loans, the tradition of accumulating significant amount of savings for college could be rediscovered.

Mr. Chairman, the committee should also ensure that the program works for borrowers, and not against them. In recent years, we have witnessed an increasing number of instances where borrowers are denied the opportunity to complete a degree or certificate program due to the closure of a school in the middle of an academic term.

All too often, the unfortunate victims of these school closings are the students who, under current rules and practices, can not be released from their guaranteed student loan obligations even though they never received the education they were promised.

We expect that there will be a rash of school closings in the coming months when many of the high default schools lose their eligibility to participate in Federal aid programs. Certainly, today there are students enrolling in schools who, unbeknownst to them, will not have the opportunity to complete their course work.

We believe the Congress should grant the Secretary the authority to treat these borrowers differently than other loan defaulters. We are convinced that the Federal Government must share responsibility for institutional failures that occur within its student aid programs and protect students who are caught in circumstances they are unable to control.

Both Sallie Mae and NCHELP have recommended that the department adopt a policy which permits lenders to cease collection efforts against borrowers whose schools close before they are able to complete their academic programs. Our proposal would allow the Secretary and the guaranty agencies to offer forgiveness of all or a portion of a student's indebtedness in school closing situations.

Finally, Mr. Chairman, in line with your committee's historic oversight role of Sallie Mae, we are renewing our request for an amendment to our charter which will merge our two classes of stock into a single class of common stock. This one-share, one-vote legislation was passed by the Senate in the last two Congresses, but the underlying bills were never signed into law.

As the committee members will appreciate, this measure is relevant to safety and soundness, and that improves our corporation's ability to raise capital and further ensures a broad base of voting shareholders.

Thank you for this opportunity to appear before you today. I would be pleased to answer any questions at the appropriate time.

[The prepared statement of Lawrence A. Hough follows:]

TESTIMONY OF
LAWRENCE A. HOUGH
PRESIDENT AND CHIEF EXECUTIVE OFFICER
STUDENT LOAN MARKETING ASSOCIATION

BEFORE THE
HOUSE SUBCOMMITTEE ON POSTSECONDARY EDUCATION
HEARING ON THE STAFFORD LOAN PROGRAM
JUNE 6, 1991

I am Lawrence A. Hough, President and Chief Executive Officer of the Student Loan Marketing Association. I am pleased to appear before you today as part of this committee's deliberations on the reauthorization of the Higher Education Act of 1965.

Sallie Mae Activities

Mr. Chairman, let me begin by briefly bringing you and the members of this committee up to date on the role Sallie Mae is currently playing in supporting postsecondary education. Sallie Mae's student loan assets now total $42.8 billion. We have financed four out of every 10 dollars of Guaranteed Student Loans outstanding today through purchases in the secondary market and warehousing advances -- collateralized loans to lenders. In 1990 alone, Sallie Mae provided more than $11.6 billion in support of education loans, nationwide. Using authority granted during the last reauthorization, Sallie Mae has launched a successful program of facilities financing for educational institutions that has financed or provided support to 121 institutions for a total of more than $1.6 billion. These funds have been used to refinance existing debt related to construction and renovation, to construct new facilities, to acquire new equipment, and to refurbish facilities in need of repair. We are pleased to have become a key player in ensuring that the infrastructure of American higher education keeps pace with the demands of the 1990s and the next century.

But Sallie Mae is more than just numbers. Since the last reauthorization, Sallie Mae has solidified its leadership role in private sector efforts to finance postsecondary education. Sallie Mae has been at the forefront of developing sophisticated products that serve student loan lenders and provide better service to schools and students. Sallie Mae's development of a state-of-the-art student loan servicing system has enabled us to service, in-house, more than half of the loans we own and provide a full range of technical assistance products to lenders who want to participate in the student loan program but cannot afford the expense of developing the unique systems needed to properly originate and service loans. Sallie Mae's leadership on the financial front has allowed us to make credit available to education loan lenders at competitive rates and to enable guarantors and secondary markets to obtain needed financing. The bottom line objective of these efforts has been to assure qualified borrowers that they will be able to obtain the funds they need to pursue their postsecondary goals.

Sallie Mae's "back room" expertise -- its unparalleled knowledge of the operational and administrative aspects of student loans -- combined with its financial acumen and the freedom granted to it by the Congress, enabled the corporation to provide emergency financial assistance to the Higher Education Assistance Foundation (HEAF) and assume management of its student loan portfolio. Sallie

Mae's management subsidiary, Minnesota Guarantor Servicing, Inc, is currently administering the HEAF portfolio and is well into the process of dispersing the HEAF guarantees among the other student loan guarantors. This process is moving along smoothly and we expect to meet the deadlines spelled out in our agreement with the U.S. Department of Education.

Reauthorization Overview

The hearings today are one of a busy schedule of presentations planned to ensure that, in your consideration of reauthorization proposals, you will hear many perspectives from the widely different constituent interests. In undertaking its review of the Title IV programs, and the Guaranteed Student Loan Program (GSLP) in particular, we believe as others have suggested already, that this reauthorization should address the issues of access, quality, and simplification. In doing so, the primary focus for evaluating ideas presented in reauthorization must be the student, the most important, yet often forgotten of the many postsecondary education constituents. Additionally, particular proposals must be evaluated in light of their cost and reliability.

Any review of Title IV should start by acknowledging the successes of the federal efforts to provide student assistance over the past quarter century. In particular, the GSLP has been a highly effective method of providing millions of students with the opportunity to attend the postsecondary school of their choice. The program has successfully leveraged federal dollars by providing nearly three times as much financial aid to students and parents as it has cost the U.S. taxpayer in federal appropriations. However, the GSLP's effectiveness in fulfilling broad access goals is diminishing and, without program change, the GSLP will fall short of meeting the challenges of this decade and the next. The loan program's ability to perform well is directly related to how the GSLP adapts to the changing educational goals of the nation's students, their families' ability to pay, and the quality and cost of attendance of the institutions they attend.

The Changing Educational Goals of Students

While my data is imprecise, it is clear that increasing numbers of students enrolled at postsecondary institutions, and perhaps, more importantly, increasing numbers of would-be students, are seeking to be retrained. They represent the generic types we all have heard from: single parents already balancing family responsibilities and current employment, while seeking to improve their earning capability with additional education; laid-off blue- or white-collar workers seeking a new profession; older citizens who, before reentering the workforce, wish to sharpen the skills acquired fifteen or twenty years earlier. For a number of reasons, the present GSLP is not well-suited to these would-be students. In fact, the rules of the present program force prospective students into higher cost programs and away from community or evening college programs. The current system does not take into account the nuances of these students' educational careers, such as periodic interruptions in study, less-than-half-time study, or the need to take courses simultaneously at multiple institutions. There are better ways to meet the needs of these aspiring students. As the nation addresses the broad challenges of strengthening its workforce through retraining, a re-tuning of the GSLP could make it an important contributor.

No matter whether the student's educational goals are a traditional four-year or graduate degree, or a vocational or career oriented program, students and families across this nation must confront, head on, the problem of gathering together the required funds to pay the costs of attendance. Today, nearly all families, regardless of economic condition, cannot meet college costs without some form of credit assistance. Fundamental to the success of the access and choice goals of public policy is the moment of truth when the student/family consumers evaluate available credit assistance alternatives and, based on that evaluation, determine in what school or program of study they should make their educational investment. From the federal perspective, we should evaluate more carefully the differences in needs and outcomes of students and their families and tailor the existing framework of assistance to reflect these varying circumstances.

The Rising Costs of Education

The continuous escalation of college costs is now a well-established reality that all of us in or around the higher education industry are confronting. This pattern of cost increase is nearly the same whether one examines the private or public sectors. At the time of the last reauthorization in 1986, the average undergraduate public and private school student budgets were $5,300 and $10,600 respectively. Today they are $7,000 and $15,000. When we next face reauthorization in 1997-98, the average costs may be as high as $12,000 and $21,000.

Looking ahead to the next reauthorization, the school population will be remarkably unchanged. The total enrollment in postsecondary education is 13.5 million today, and is projected to be 13.9 million in 1997-98. Compare this relative stability to the dramatic increase in funds needed to pay the costs for these students. By merely looking at enrollments and cost projections, we see that in 1997-98 the nation's students and their families will need approximately $50 billion more in funds than they did this past fall. Over the course of the five years following this reauthorization, they will need as much as $150 billion in additional financial resources. Obviously, this need will be met in various ways as it is distributed across family incomes. For families in the lowest 20-25 percent of annual income, very little of the needed increment will come from income except as provided by the student. In the middle group, where our present need analysis system provides some eligibility for state, federal, and institutional support, much more of the incremental resources will be expected to come from the already extraordinary contributions made from day-to-day income sources. At the higher end, though the bite will clearly be more difficult to manage, additional needed funds will probably be found through income, investments, or borrowing, with very little support from federal sources. As presently constituted, little of the $150 billion in estimated incremental resources is likely to come from the existing federal loan programs.

Meeting the Needs of Low-Income Families

The student borrower from a family with low income has become the "typical" Stafford loan recipient. At the lowest end of this group, program data indicates higher than average loan default and higher than average program drop-out experience. In addressing the needs of the lowest-income families, we must acknowledge that the present GSL program is poorly suited to the special challenges of extending credit to this segment of the student population. Moreover, as a consequence of the impact of high default levels from higher risk borrowers, the Stafford program has suffered in the eyes of the taxpayer. And, it is clear to us that students have suffered as a result of the nearly constant efforts to set the program straight. It is too early to tell what effect recent statutory changes in program rules and school eligibility requirements will have on the long-term health of the program and on student access. We believe that it may be time to look specifically at serving the most disadvantaged students in a unique manner and to design delivery concepts solely for this set of students. We suggest that if the quality problems of curriculum standards, ability to benefit selection, and academic progress monitoring are addressed first, then a loan program supplement to the Pell Grant, with the potential for repayment terms which provide for yearly, income-related cancellation, could serve these students more effectively than the current approach.

Assisting Middle-Income Families

The middle-income student represents a second focal point in this discussion of choice and access. Sallie Mae is aware of the growing sentiment that middle-income families need more help in meeting college costs. As the following excerpts from House Report 89-621, which accompanied the Education and Labor Committee's version of the Higher Education Act of 1965, illustrate, concern for middle-income families has long been a focal point of the GSLP:

> College costs in this country have now spiraled to a point at which it is not just the very needy who require financial aid. Many students from middle-income families are also finding it difficult to meet the increasing costs of

a college education.

The report quotes the Commissioner of Education who explained that, according to the need analysis formulae in place at that time, college costs could eat up as much as one-quarter of the available income of a family with two children in college. He added,

> To cite these facts is not to contend that these middle-income families should be relieved of responsibility for paying the costs of higher education for their children. It is rather to suggest that this heavy concentration of expenses should be spread out over more than the four years of college through the "loan of convenience" described in Part B of Title IV.

That middle-income "loan of convenience" has become a "loan of necessity" for a growing number of low-income families and students. Many middle-income families do not qualify for Stafford loans and are restricted to borrowing through the non-subsidized PLUS program on behalf of their children. In today's college market, the aggregate $20,000 available under PLUS does not buy a four-year college education at most schools. Parents and students have been forced to invade retirement funds or use up the equity in their homes in order to fill in the gap left between federal resources and the costs of college. Alternatively, other families have lowered their expectations and reluctantly concluded that the school of choice is simply not an option.

To restore more beneficial support to these families, two long recognized deficiencies of the system of evaluating need require change. First, proposals of the type offered by members of this committee, and by the National Association of Student Financial Aid Administrators (NASFAA) and the College Board, to modify the treatment accorded home equity in the Congressional Methodology should be adopted. If the family has invested in its own home, a portion of the equity in that home is assumed to be available to help meet college costs. Second, under the current need analysis formulae, middle-income, home-owner families are doubly penalized for being thrifty and for planning ahead for their children's education. If the family has foregone vacations or luxury items in order to put a few dollars aside to enable their children to attend college, then their eligibility for federal aid is reduced in proportion to the amount of their thrift. Currently, the need analysis system not only penalizes savers, the national publicity on this "savings tax" has led many families who do save to omit those assets from the financial aid form or place them in the name of a relative or other person who is not subject to need analysis. We envision a program that will reward middle-income parents for looking ahead to the future and reduce the dependency of these families on high cost loans as the means for meeting college costs. Under such a program, families would be encouraged to save for

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college and would be rewarded when the presence of student/family savings open up access to partially subsidized, guaranteed loans. If saving were a prerequisite for receiving low-interest loans, maybe this traditional middle-class value could be rediscovered and integrity could be restored to the student aid application process.

The Consequences of School Closures

Mr. Chairman, in recent years we have witnessed an increasing number of school closures in the middle of an academic term. The unfortunate victims of these school closings are the students, including those who, under current rules and practices, cannot be released from their Guaranteed Student Loan obligations even though they never received the education they were promised or are owed refunds by the school which, if made, could reduce or eliminate their loan debt. In the near-term, we expect that more and more borrowers will be caught in this circumstance. Later this month, more than 300 schools will receive notices that, due to their excessive default rates, they will no longer be eligible to participate in federal student aid programs. Many of these schools, which are dependent on the aid programs as a source of tuition revenue, will cease operations. We are certain that there are students enrolling at these schools today who will receive Guaranteed Student Loans but will not be able to complete their educational programs.

In addition to borrowers, lenders are also left with unexpected liabilities in the case of school closings. As the program is administered today, lenders are not in a position to provide relief for these borrowers and instead are required by federal and guarantor rules to proceed with normal, diligent collection efforts. Many of these borrowers do not repay, eventually default and, in the normal course of events, insurance claims are honored by the guarantor and appropriate reports are made to credit bureaus. However, in some cases, in order to defend themselves, borrowers initiate lawsuits against the bank and the guarantor (in addition to the school), and claim to have a legal defense against repaying the loan (e.g., because they did not receive the education they were promised). To make matters worse, in connection with some of these suits, the Department of Education attempts to side-step its reinsurance obligation by, in effect, attributing the school's failures to the lenders and holders, even though they had no responsibility for the school closure. They do this by declaring the loans uninsured.

It seems to us, Mr. Chairman, that someone should be looking out for the students who will find themselves caught in the coming rush of school closings. We are disappointed that the Secretary is not taking the lead on this issue. On May 29, 1991, Undersecretary of Education Ted Sanders informed this committee that the Department does not have the authority to treat borrowers who do not repay their loans after having been caught in closed school situations any differently than other loan defaulters. While the Department's Inspector General pointed out, at that time, that ED has the authority to assist borrowers who are victims of school fraud, that will probably not suffice. We believe that Congress should direct the Secretary to assist these borrowers and help them avoid the consequences of being mis-classified as loan defaulters. Yes, it will cost the federal government some money to relieve these borrowers of their indebtedness, but there is no escaping the fact that this is a federal responsibility. Ultimately, the GSLP is a federal program which certifies schools as "eligible" for participation in the program. Borrowers and lenders rightly rely on that federal approval and should not be left on the hook for circumstances over which they have no control. As long as the federal government allows schools in shaky financial condition or with poor quality programs and high default rates to participate in the GSLP, the federal government must be willing to deal fairly with the economic consequences of that participation.

We suggest that Congress direct the Department to adopt, for guaranty agency programs, the model that has been in use for FISL insured loans for many years and was offered by Sallie Mae and the National Council of Higher Education Loan Programs in response to the Department's November 20, 1990, Notice of Proposed Rulemaking on the GSLP. Under this proposal, when a guaranty agency or the Secretary learns that a school is closed, loans made to students to cover an uncompleted academic term would be immediately submitted to the guaranty agency for insurance payment. These loans would not be considered to have defaulted and would not count against a guaranty agency's reinsurance "trigger" rate. Guaranty agencies, in consultation with the Secretary, would then review these loans and determine if the borrower should still be liable for all or a portion of the debt -- based on the education received and the circumstances of the school closing. Loans that were deemed to be valid obligations could be repurchased by the lender who would perform normal collection efforts. Adoption of this process will bring a new degree of fairness to the GSLP and a recognition that the federal government does indeed have a responsibility to assist students who have relied on a government imprimatur in assuming debt and to treat fairly the lenders who have undertaken to finance them.

Assuring the Stability of the Guarantee System

All providers of private capital for the GSLP have a heightened concern these days for the stability of the guaranty agency system. Any threat to the insurance that is the foundation of GSLP lending is a threat to the continued viability of the program. Even the perceived potential for loss has an adverse impact on participation and investment.

Sallie Mae supports efforts to increase government oversight of guaranty agency financial reporting and to establish more public accounting of the accumulation and use of reserve funds. Providing for timely, standardized, and thorough financial reporting of the guarantor and its auxiliary activities, such as servicing or secondary market support, would bring to bear on their activities the benefits of market discipline. We join with the Consumer Bankers Association and the American Bankers Association in their calls for the establishment of a standing contingency plan for protecting loan guarantees in the event of a guaranty agency's inability to meet its financial obligations. At a minimum, the Secretary should be required to step in immediately and honor the loan guarantees issued by a troubled guarantor until a permanent solution is reached. We also applaud the attention reflected in the President's 1992 budget submission on this subject.

Enhancing the Consolidation Loan Program

Mr. Chairman, we would also like to take this opportunity to urge the extension of the loan consolidation program authorized by the Higher Education Amendments of 1986. This program has been extremely popular with borrowers and has successfully enabled many students to better manage their student loan repayment obligations, thus, avoiding unnecessary loan delinquencies and defaults. As of May 31, 1991, Sallie Mae has consolidated nearly $2 billion in loans for more than 122,000 borrowers. The default rate on consolidation loans held by Sallie Mae is significantly lower than for the GSLP as a whole. Borrowers will continue to need access to consolidation loans as college costs continue to rise and as program loan limits are increased.

Based on our experience as a consolidation lender and comments made to us by consolidation borrowers, we have developed a number of suggestions for improving the consolidation program. These ideas were originally transmitted to this committee on April 8, 1991. Permit me to highlight three of these ideas for you: First, we believe that the repayment period on smaller balance consolidation loans (loans with balances between $5,000 and $10,000) be extended from ten to twelve years. Because most consolidation borrowers pay a higher interest rate after consolidation than they did on their underlying loans, we believe some extra repayment relief, in the form of a longer term, is appropriate. Second, we believe that spouses should, if they so choose, be permitted to consolidate their debts jointly. This provision would reflect the fact that more and more young couples are entering married life with two sets of student loans. By allowing them to merge these obligations, the family would be entitled to a longer repayment term and would be better able to meet their repayment obligations. Third, we believe that loans that have previously been defaulted, but which the borrower has converted to good standing through regular repayment, be permitted to be included in consolidation loans. Borrowers who have experienced repayment difficulties at the beginning of their post-academic careers but who have subsequently acquired the means to repay their loans should be further encouraged to repay their loans by being afforded the opportunity to take advantage of the consolidation program. With these revisions, the consolidation loan program will provide even greater financial relief to borrowers and their families.

Sallie Mae Charter Amendments

Lastly, Mr. Chairman, we have this year renewed our request to merge our two classes of stock (one voting, one non-voting) into a single class of common stock (the one share-one-vote amendment to our charter). This legislation was passed by the Senate in the last two Congresses, but the bills which it was part of were never signed into law. The one-share, one-vote measure is relevant to concern regarding the safety and soundness of Sallie Mae, in that it improves the corporation's ability to raise capital and further, it ensures a broad base of voting shareholders.

Thank you for this opportunity to appear before you today. I would be happy to answer any questions.

Chairman FORD. Mr. Joe Paul Case.

Mr. CASE. Thank you, Mr. Chairman. I am Joe Paul Case, and I am Dean of Financial Aid at Amherst College. I'm also a member of the reauthorization task force of the National Association of Student Financial Aid Administrators, NASFAA.

It is a pleasure to have the opportunity to express the views of NASFAA and its nearly 3,300 members on changes that we believe should be made to the guaranteed student loan programs.

Let's recall the original purpose of the loan program. Representative Edith Green said in 1965 that the GSL program was designed primarily for those students who come from middle income families. Needy students are now relying on the loan programs that were not designed for them.

We need to reverse that trend in reauthorization. This is the most critical challenge you face after the issue of program integrity. There are problems with the GSL programs, and NASFAA wishes to be constructive in helping the subcommittee in the reauthorization process.

We need, however, to step back from the problems in the loan programs to remember that they are working and are working well. Since the inception of the GSL programs, over $100 billion has been lent, which represents some 48 million loans, with nearly 91 percent in repayment or paid in full. These loans represent aspirations fulfilled, career goals achieved, and studies completed with degrees awarded.

To meet individual credit needs and to allow for adaptability in institutional aid policies: NASFAA recommends increasing the annual maximum loan limits to $4,000 for first and second year students, $6,000 to other undergraduate students with an undergraduate aggregate maximum of $26,000; we recommend the annual graduate maximum be raised to $10,000, with a graduate aggregate maximum of $50,000. These maximums would apply to both the Stafford and SLS loan programs. We suggest for the PLUS program annual limits of $20,000, with an aggregate set at $100,000.

We can not predict whether college costs will level off or continue with increases beyond the CPI. We suggest the necessity for these increases to meet the credit needs of students and parents whose loan limits have not been changed in 5 years while college costs have risen and may rise through the 5 year period of an extended loan.

Higher loan limits will help reduce the problem of multiple loans, especially for students who continue on to graduate or professional studies. Currently, students may find they must borrow from the Stafford, SLS and Perkins loan programs to meet their college expenses. With higher loan limits, the borrower in repayment may need to write only one check a month instead of several, thus reducing confusion and errors.

Next, NASFAA recommends that institutions be allowed to establish lower institutional loan limits than those prescribed in statute. We believe that this change will give institutions the flexibility to design policies to meet local campus conditions.

Two, also related to our recommended increased loan limits, NASFAA suggests extending the current 10 year repayment period to 15 years to make debt burdens more manageable. The 10 year repayment has not been changed since the inception of the program, and it is time to make this change for students.

Three, NASFAA recommends the consolidation of the deferment provision for student loans in three deferment categories, those being an in-school deferment for half-time or greater attendance, an unemployment deferment for up to 2 years, and a temporary total disability deferment for up to 3 years. Currently, there are 13 different deferments authorized by law. Confusion is the result.

Many of the deferments do not apply to past borrowers, which created equity problems, and many deferments affect only a limited number of individuals.

Finally, we are aware of no evidence or studies that indicate such deferments change the actual academic choices or career objectives of students. We believe that simplification of the deferment process will help curb technical defaults. These are students who go into default despite their good faith efforts to understand and obtain a deferment.

We fully understand the expense that is involved in our recommendations. NASFAA believes it is important to suggest modifications in the Act which will not only reduce the program costs but also represent sound public policy.

We suggest the following. Four, SLS eligibility should be limited to graduate and professional students and to undergraduate students whose eligibility is established through professional judgment. NASFAA believes that SLS loans have been utilized too frequently by some undergraduate students and should be used only as a last resort for these borrowers. Although NASFAA believes that much of the inappropriate usage has already been curbed by legislative means, we make this recommendation as an additional safeguard.

Five, we believe it is appropriate to establish an 8 percent Stafford loan interest rate while the student is in school and for 4 years of repayment, and then change to an annually set fixed interest rate based on the 52 week T-bill plus 3.25 percent, capped for student borrowers at 15 percent.

NASFAA strongly believe that the in-school intrasubsidy is still an important component for providing access to education and should be maintained. NASFAA feels that this is a reasonable cost containment approach, given the low interest rate and the likelihood that a borrower will be in a better financial position 4 years after repayment begins.

More importantly, NASFAA feels that the Federal money saved by this change in subsidies can be used to fund grant programs. With grant aid for needy students substantially increased, they would not have to borrow so much or at all to finance their education, and would not be adversely affected by these changes.

And in that regard, NASFAA strongly urges the Congress to change the funding structure of the Pell grant program by creating an entitlement for students, and also urges you to increase substantially the maximum award.

Adoption of our Pell grant recommendations will allow reestablishment of the program as the foundation of Federal student aid; will help reduce unwise borrowing by many lower income students who should be supported by grant aid; will assist in the reduction on defaults, thereby saving the government monies needed to fund the Title IV grant and work programs; and, most importantly, will provide a prudent policy to support and assist students and their families as they finance their education.

We would also note the committee, as a part of its default legislation in 1988, approved making the Pell grant program an entitlement.

NASFAA looks forward to working with you to ensure that student and parental credit needs are met, to help them pay for college, that costs in the Federal loan programs are reduced, that complexities are reduced, and that tax dollars are protected.

I would be pleased to answer any questions you may have, and thank you for the opportunity to testify.

[The prepared statement of Joe Paul Case follows:]

STATEMENT OF THE NATIONAL ASSOCIATION OF STUDENT FINANCIAL AID ADMINISTRATORS

BEFORE THE HOUSE SUBCOMMITTEE ON POSTSECONDARY EDUCATION

PRESENTED BY

JOE PAUL CASE
DEAN OF FINANCIAL AID
AMHERST COLLEGE

June 6, 1991

Mr. Chairman and Members of the Subcommittee, my name is Joe Paul Case and I am Dean of Financial Aid at Amherst College. Currently, I am also a member of the Reauthorization Task Force of the National Association of Student Financial Aid Administrators (NASFAA). It is indeed a pleasure to have the opportunity to appear before you today to express the views of NASFAA and its nearly 3,300 members on changes that we believe should be made to the Guaranteed Student Loan Programs (GSL). The goals of our loan recommendations, in combination with our other Title IV proposals, are to reduce student loan defaults; to ensure that these programs not only meet the credit needs of students and parents, but, also do not overburden students with debts; and, at the same time, to guard against those few who would defraud and abuse the system.

Let us recall the original purpose of the loan program. As former Subcommittee Chairwoman Edith Green said on the House floor in 1965 during debate on the earliest Higher Education Act, the GSL program "was designed primarily for those students who come from middle-income families." Ten years of underfunding and cuts in the grant programs have, in part, contributed to students relying on the federal loan programs that were not designed for the type of borrowers currently in the program. It is no wonder that default and subsidy costs have skyrocketed. As a profession, student financial aid administrators are dismayed by the amount of borrowing that has been forced on students recently. We need to reverse that trend in this Reauthorization. This is the most critical challenge you face after the issue of program integrity.

Certainly, there are problems with the Guaranteed Student Loan Programs and NASFAA wishes to be constructive in helping the Subcommittee in the Reauthorization process. A number of NASFAA's recommendations are identical or similar to those recommended to the Subcommittee for consideration by the Department of Education, the Department's Inspector General, the General Accounting Office, and by Senator Nunn's Subcommittee on Investigations report. But, other proposals we make strike out in new and controversial directions.

I intend to discuss our specific recommendations for helping reduce loan defaults later, however, we need to step back from the problems in the loan programs to remember that the federal student financial assistance loan programs are working and are working well. Over 10,000 lenders participate in the loan programs. As estimated by the Department of Education in FY-92 approximately 4.7 million student loans will be made providing $12.4 billion in loan funds for postsecondary education. Further, the average undergraduate loan is $2,425 and the average graduate loan is $5,747. Also, since the inception of the GSL Programs, over $100 billion has been lent through FY-89 which represents some 48 million loans with nearly 91 percent in repayment or paid in full.

At my own campus, nearly 500 students borrowed in excess of $1.1 million in 1990-91 to provide an average loan of $2,300 to help pay their college bills. Further, at Amherst 72 parents borrowed $251,000 in PLUS loans.

These are impressive figures, both nationally and at my college, but I believe even more impressive is the educational opportunity provided to those individuals who receive student loans. The fact is that in the history of the program, billions of dollars in loans have been made and millions of loans are being repaid or have been repaid. These loans represent aspirations fulfilled, career goals achieved, and studies completed with degrees awarded.

Federal student loan programs have no international comparison and our nation is richer for them. Even with news of the problems in American education, student loans have help provide us with an educated citizenry that contributes to our economic competitiveness, national defense, research and development agenda, health care system and so many other aspects of our national life and well-being.

CREDIT NEEDS AND FLEXIBILITY

To meet both students' and parents' credit needs and to allow for adaptability in institutional student aid policies, we urge the following:

(1) NASFAA recommends increasing the annual maximum loan limits to $4,000 for first and second year students, $6,000 to other undergraduate students with an undergraduate aggregate maximum of $26,000. We also recommend the annual graduate maximum be raised to $10,000 with a graduate aggregate maximum of $50,000. These maximums would apply to both the Stafford Loan and SLS programs. NASFAA's recommended aggregate total for the Stafford, SLS, and Perkins loan programs would be $52,000 for undergraduates and $115,000 for graduate students.

We further recommend for the PLUS Program, the program available to parents, annual limits of $20,000 with an aggregate level set at $100,000. NASFAA concludes that such PLUS limits are appropriate with the further protection that credit checks are conducted, that funds are either electronically transferred to the institution or checks are made co-payable to the institution and the parent borrower, and that the loan proceeds are multiply disbursed. This change would allow many creditworthy parents to borrow up to the full amount of their Expected Family Contribution. We propose increased loan limits for these reasons.

If you have recently paid for a postsecondary education for your child, then it will be of little surprise that there have been increases in tuition, fees, books and supplies, room and board expenses. For example, the percent change from 1980-81 to 1989-90 (est.) in postsecondary education's cost of attendance reveals increases of 133.9 percent for private universities, 123.2 percent for private four-year colleges, 105.3 percent for public universities, 105.2 percent for public four-year colleges, and 72.5 percent for public community colleges. These figures represent the average cost to students rather than the average charge by institutions. The personal per capita income of Americans rose by only 77.6 percent over that decade.

Consequently, we suggest the necessity for these increases in the maximum and aggregate loan amounts since they will meet the credit needs of students and parents whose loan limits have not been changed since the last Reauthorization at the same time college costs have risen dramatically. We cannot predict with certainty whether college costs will level off or continue with increases beyond the Consumer Price Index as they have at times in the past. Perhaps to you, our recommendations would increase loan limits by what can only seem to be large amounts, but at the conclusion of this reauthorization cycle, near the year 2000, these may be deemed as modest amounts depending on what a postsecondary education costs students and parents.

Higher loan limits will help reduce the problem of multiple loans. Currently, students may find to meet their financial need they must borrow from the Stafford, SLS and Perkins loan programs to meet their college expenses. These multiple loans require such a former student to write three different loan checks each month. With higher loan limits the borrower in repayment may need to only write one check a month, thus reducing confusion and errors. This change could be of significant help, especially for those individuals who continue on to graduate or professional studies.

Further, our recommendations must be considered as interrelated, since NASFAA makes recommendations for increased grants for needy students, reduced student eligibility for the loan programs in some cases and decreased federal interest subsidy and program costs. I will discuss further in this testimony a number of these proposals.

(2) In conjunction with our recommended increased loan limits for the Guaranteed Student Loan

Programs, NASFAA's recommendations would also establish reduced annual loan limits for three-quarter and half-time students. In addition, NASFAA recommends that institutions be allowed to establish lower institutional loan limits than those prescribed in statute. This would mean, if the Congress adopted our proposals for higher loan annual and aggregate maximums that, for example, an institution may decide that for its students in the Stafford Loan Program that the institution would have a $2,700 annual limit for the first two years of school, a $4,000 annual limit for the next two years and a $17,400 aggregate undergraduate limit, rather than our recommendation for a $4,000, $6,000, and $26,000 annual and aggregate limits respectively. We believe that these changes are necessary to prevent excess borrowing and the potential for default at certain institutions and give institutions the flexibility to design policies to meet local campus conditions and packaging objectives.

I would also note that as a result of last year's Reconciliation Act, financial aid administrators have the authority to deny or reduce the amount of a student's loan in certain circumstances. NASFAA supported this provision and believes that it will be a useful tool for institutions to use in default prevention. We appreciate the Congress's willingness to grant us this authority in the face of opposition from the Administration and others. We well understand to reject a student's loan or to reduce the amount of his or her loan can mean the difference between enrollment or not. Our job, as we see it, is to facilitate a student's attendance, but, at the same time, some students should not borrow and other students, we know because they are foolish enough to tell us, intend to use the loan proceeds for non-education related expenses or tell us they intend to default. We continue to support this change because if institutions are to be responsible for their default rates, NASFAA believes that this provision will provide them with a tool to actively manage student loan indebtedness and aid packaging policies. We do not mean to suggest that this will be a "magic bullet" which will solve the default problem, but as aid administrators become more accustomed to using this authority, then, we believe time and future evaluation will best show its efficacy. We are very hopeful.

(3) Also related to our recommended increased loan limits, NASFAA suggests extending the current 10 year repayment period to 15 years to accommodate borrowers who take advantage of these increased loan limits. NASFAA believes that this change is necessary to ensure that borrowers will be able to afford the higher monthly loan payments associated with such increased borrowing. Keeping monthly repayments affordable for borrowers will keep the incidence of default at a minimum. The 10 year repayment has not been changed since the inception of the program and it is time to make this change for students. As an example, let us say that a student borrowed $40,000 at 9 percent. This borrower, having to repay their loan in 10 years, would have a monthly payment of $506.71 contrasted to paying only $405.71 over 15 years.

(4) NASFAA recommends a consolidation of the deferment provisions for student loans into three deferment categories, those being a) an in-school deferment for half-time or greater attendance; b) an unemployment deferment for up to two years; and c) a temporary total disability deferment for up to three years. Currently, there are 13 different deferments authorized by law. Confusion is the result. Many of the deferments do not apply to past borrowers, which creates equity problems, and many deferments affect only a limited numbers of individuals. Finally, we are aware of no evidence or studies that indicate such deferments change the actual academic choices or career objectives of students.

We believe that simplification of the deferment process will help curb "technical defaults," that is, in most instances, students who go into default despite their good faith efforts to understand the deferment categories and obtain a deferment. Along these lines, NASFAA also suggests rescinding the current requirement that a student enrolled on at least a half-time basis must borrow again in order to obtain a deferment. Consistent with the NASFAA's broad policy goal of reducing reliance on loans, we believe it makes no sense to require a student to borrow another loan in order to receive a deferment on a previously borrowed loan, provided the student is enrolled at the appropriate level.

Finally, NASFAA recommends allowing deferments for an individual attending an institution eligible for Title IV aid but which does not participate in the Part B programs. NASFAA believes that an individual student should receive a deferment if that student's institution participates in any Title IV student assistance program, even though the institution may not participate in the Stafford Loan Program.

REDUCING COSTS

We fully understand the expense that is involved in our recommendations for improvements in the loan and the grant programs to serve deserving students and parents. NASFAA believes it is important to suggest modifications in the Higher Education Act which not only will reduce program costs, but also represent sound public policy. In this category we suggest the following:

(5) We believe it is appropriate to establish an 8 percent Stafford Loan interest rate while the student is in-school and through four years of repayment and then change to an annually-set fixed interest rate based on the 52-week T-bill plus 3.25 percent, capped for student borrowers at 15 percent. If the market rate goes below 8 percent, the interest rate remains the same and the surplus would go to help offset default costs. NASFAA strongly believes that the in-school interest subsidy is still an important component for providing access to education and should be maintained.

This type of interest rate determination is feasible from a technical standpoint, yet should not be not overly confusing to students or no more confusing than the current policy changing from 8 percent to 10 percent. The maximum interest rate for students is set at 15 percent to protect students from periods of super-inflation. There is no interest rate cap for lenders. The provision would apply to all new loans made for periods of enrollment beginning on or after July 1 of the year following enactment of the new law.

Since cost containment in the student aid programs is a major issue, NASFAA feels that this is a reasonable approach given the low 8 percent interest rate and the likelihood that borrowers will be in better financial position four years after repayment begins. More importantly, NASFAA feels that the federal money saved by this change in subsidies can more appropriately be used to fund grant programs for needy students. If grant aid is substantially increased, needy students would not have to borrow so much, or at all, to finance their education, and would not be adversely affected by these changes.

(6) We recommend an increase in the interest rate cap in the SLS and PLUS programs to 15 percent from the current 12 percent cap. This proposal reduces federal costs in these programs in the event of high interest rates to assure a continued federal commitment to funding need-based grant programs for students. NASFAA makes this recommendation in conjunction with the recommended increased loan limits in the need-based Stafford Student Loan Program. If these increased loan limits are adopted, then needy students who must borrow will be able to do so under the federally subsidized Stafford Program (and in some case, the Perkins Loan Program) and will not be adversely affected by the increased cap in the event of high interest rates. Assuming also that grant assistance is significantly increased for needy students, borrowers under the SLS and PLUS loan programs will be students and families who do not need federal subsidies and, therefore, can be expected to absorb a greater share of increased interest costs in the event of high interest rates.

(7) The current law specifies a $50 monthly minimum repayment. We suggest increasing the required minimum monthly repayment to $75 for new loans to account for inflation and to correspond with NASFAA's suggested increases in loan limits. In addition, given NASFAA's suggested increase in the repayment period to 15 years, the suggested increase is necessary to save interest costs for borrowers who enter repayment with relatively low aggregate loan amounts.

(8) We suggest that the Congress consider establishing origination fees of 5 percent for SLS loans and 3 percent for PLUS loans. NASFAA recommends these origination fees in the SLS and PLUS programs as an effort to defray the cost of defaults in the Guaranteed Student Loan Programs. Reducing the overall cost of the Part B loan programs will enable the federal government to apportion increased funds into the federal grant programs, such as the Pell Grant and Supplemental Educational Opportunity Grant programs. Further, if NASFAA's suggested amendments raising loan limits in the Stafford Student Loan Program and limiting undergraduate student eligibility for SLS loans are enacted, then enactment of this provision will have a very limited effect on needy undergraduate students.

(9) SLS eligibility should be limited to graduate/professional students and to undergraduate students whose eligibility is established through professional judgment. NASFAA believes that SLS loans have been utilized too frequently by some undergraduate students and should be used only as a last resort for these borrowers. Although NASFAA believes that much of the "inappropriate" usage has already been curbed by legislative means, we make this recommendation as an additional safeguard.

(10) NASFAA would ask the Congress to suspend from eligibility for Part B loans any incarcerated student. The current law and regulations allows, under certain circumstances, incarcerated individuals to receive a student loan. We believe this is neither wise public policy, nor

does it serve the best interests of the incarcerated individual who upon release will have a difficult enough transition without having to worry about repaying a student loan. We make further recommendations regarding the eligibility and financing the education of those serving time in prisons, but do not suggest their total elimination of eligibility from all the Title IV programs.

(11) We recommend increasing the criminal penalties associated with the continuing problems of fraud and abuse. NASFAA believes that, in addition to reinforcing institutional administrative requirements and increasing funding for Education Department administrative monies to oversee the programs, it is also necessary to strengthen the Department's disciplinary authority through appropriate increases in the penalties associated with fraud or abuse. We suggest doubling the financial and imprisonment maximums to act as a deterrent for those few who may abuse the system. We further suggest that any funds received as a result of these provisions or other administrative or criminal fines, be returned for allocation to students under the Pell Grant Program, or be utilized by the Department for administrative purposes, rather than reverting to the Treasury.

(12) The Income Contingent Loan Program demonstration project has not proved its worth and should be not be reauthorized.

DEFAULT PROPOSALS

I want to address the topic of student loan defaults which is one of the most important areas you will face in this Reauthorization. Every Member should be aware that the steps already taken to reduce student loan defaults are working and more recent changes need to be given a chance to work. The mindset that too many borrowers once had that they could default on their loan obligations without consequence is disappearing. Student borrowers now know that their credit ratings will be affected by a loan default, that their federal income tax refunds can be withheld to pay for a defaulted loan, and that they face not only efforts to collect their debts by collection agencies, but that the Justice Department will prosecute them.

There are cases in which individuals have gone to closing on the purchase of a home and a student loan default on the records has prevented them from obtaining a loan for that home. U.S. Attorneys in Philadelphia have seized the automobiles of a handful of professionals who refused to acknowledge their college loan debts. Imagine yourself in the position of these individuals who have defaulted and, subsequently, find that they cannot close on their new homes, that their car is not in the driveway one evening, or that the tax refund they were expecting will never be issued. These measures are harsh, but for those who blatantly abuse the government-backed student loan system, these remedies are necessary and appropriate. People are getting the message.

However, let me stress that most students are not defaulters and most do repay their loans promptly and fully. Many of the individuals who do default typically are non-high school graduates who have not completed their program of postsecondary education, are underemployed or unemployed, or are single-parent heads-of-households who do not have the income to repay. For many of these individuals, a student loan default creates additional hardships in their already difficult personal circumstances. And, let us not forget that the student loan default problem did not appear overnight. A prime reason the situation became so serious is that the Department of Education for so many years for whatever reason--lack of attention to the problem, absence of leadership, or inadequate resources--did not conduct the required proper oversight and management of the student loan programs. NASFAA is cautiously optimistic that the recent student financial aid management changes announced by Secretary Alexander will result in these crucial programs finally getting the attention and proper management that they deserve.

It is also important to note that one reason default costs to the government have risen is that more needy students are borrowing greater amounts because of the decrease in grant funds. Cumulative loan volume has grown from $21.2 billion in 1980 to $101.6 billion in 1989. A consequence of this growth is an increase in default claims paid by the government, even though the rate of default has remained fairly stable, i.e. 10.1 percent in FY-80 to 9.2 percent in FY-89.

NASFAA does recognize that curbing the incidence of student loan defaults is of utmost importance during this Reauthorization. Congress and the Department of Education have already done much to avert loan defaults--and many of these actions still need time to show results. NASFAA, however, recommends the following additional changes to protect valuable federal funds in the student loan programs and, equally as important, to safeguard students from the negative consequences of having a default on their credit record.

(13) NASFAA strongly urges the Congress to change the funding structure of the Pell Grant Program by creating an entitlement for students rather than maintaining the current discretionary appropriation system. Since the Pell Grant Program's first authorization in FY 1973, the Appropriations committees have funded the program at its authorized maximum only three times--most recently in FY 1979. In all other years, the program maximum has been below the policy levels set by the authorizing committees. The Higher Education Act authorizes a Pell Grant maximum award for Academic Year 1991-1992 of $3,100. Federal funding for that year allows for a maximum Pell Grant award of $2,400--a gap of $700 between the authorized amount and the appropriation. We must remember, as we conclude this authorization period with a $2,400 maximum Pell Grant, the appropriated maximum Pell Grant at the beginning of the authorization in Academic Year 1987-88 was $2,100. This is an increase of only $300 in five years which is barely a 14 percent increase. Since the last Reauthorization the cost of attendance for college many years has risen faster than the Consumer Price Index and appropriations for this foundation program have fallen short of what is necessary to provide student access to postsecondary education. This

fact has necessitated increased borrowing on the part of needy students and has contributed--we believe significantly--to the default problem.

(14) To curb defaults, again NASFAA recommends limiting eligibility for the Supplemental Loans for Students (SLS) Program to graduate/professional students and to undergraduate students whose eligibility is established through professional judgment.

(15) NASFAA recommends continuation of the current requirement that a student be enrolled on at least a half-time basis to be eligible for a Part B loan. We note that, in some cases, a student would not enter repayment for excessively long periods of time if such loans were deferred for students enrolled less than half-time. While NASFAA is sensitive to the needs of those students who cannot enroll in postsecondary education on at least a half-time basis, we feel that allowing these students to borrow does not serve them well and may contribute to default costs.

(16) NASFAA recommends that the seller of a loan be required to notify borrowers that their loans have been sold. Lack of direct information to students regarding sale of their loans is a factor contributing to default, and NASFAA believes that, although some lenders currently notify students of such sales, such notification should be required in statute.

FURTHER PROPOSALS

We suggest other proposals and modifications of the current loan programs which include the following:

(17) The current law provides that the borrower alone is responsible for repaying his or her student loan. NASFAA recommends encouraging employer repayment of student loans as part of

an employee's benefit package through some mechanism such as a tax incentive.

Increasingly, persons entering the workforce spend a substantial portion of their earnings to repay student loans they assumed while obtaining their postsecondary education. While some parents are able to help their children repay their loans, for the most part the responsibility rests with the borrower. As a means of helping these persons meet their loan repayment obligations, NASFAA proposes to establish a new set of employee benefits in the tax code, which would provide incentives for an employer to make loan payments on behalf of its employees.

If the loan amount paid by an employer on behalf of an employee could be treated as untaxed income, then limited financial benefits would accrue to both the employer and to the employee. The employer, for example, would not have to pay FICA or other kinds of employment earnings taxes on amounts paid for the employee. Similarly, employees would also receive tangible benefits, but since the amount paid on their behalf would be treated as untaxed income, it would also reduce their tax liability. While this inducement would result in a small reduction of revenue for the government, it would help to insure repayment, and perhaps on an accelerated basis, so as to reduce the government's costs associated with the federal loan programs. These changes would require modifications to statutes other than the Higher Education Act. We believe this concept, if adopted, could be effectively used by employers as a way of recruiting and retaining qualified employees, while also benefiting former students and enhancing loan repayment.

(18) NASFAA recommends establishing a set of actions in the Higher Education Act in the event of a guaranty agency's insolvency to protect the integrity of the loan system and to ensure that loan capital would continue to be available to students. In July 1990, when the Higher Education Assistance Foundation declared bankruptcy, there was much concern among the lending community, other guaranty agencies, postsecondary institutions, the media, and, most importantly, students and

parents because specific procedures to address guaranty agency insolvency were not in place. Had the situation drifted into a "panic" due to lender uncertainty about the status of their outstanding and new loans, it is possible that lenders could have taken steps to minimize their exposure to risk or even suspended their participation in the GSL programs. If this had occurred, then further guaranty agencies may have found their agencies facing undue financial risk. Even more alarming, it is likely that students—especially low-income borrowers or those enrolled in short-term programs—would have experienced access problems.

Our recommendation would require a study to determine the mechanisms and timelines for dealing with such insolvency if it should occur in the future. Until additional information is available, NASFAA recommends that, in the event of a guaranty agency failure, the Department would manage both the reserves of the agency and the reinsurance function.

(19) We suggest a change to allow married students to consolidate their loans. Given the large amount of borrowing necessary for some students to finance their postsecondary education, it is possible that some married students would have very large, and potentially unmanageable, combined monthly loan payments. Giving married couples the option to consolidate their student loans will allow them to more easily manage their education debt, along with their other expenses, and may have the positive effect of reducing defaults for those married couples who would not be able to afford separate loan payments for each individual. NASFAA feels that this suggested amendment is especially relevant given NASFAA's suggested increases in annual and aggregate loan limits. This recommendation already has been approved by the Education and Labor Committee in 1988 when H.R.4986 was cleared for floor action, but never was scheduled for debate.

(20) We suggest permitting single disbursements for loan periods of 90 days or less. The Omnibus Budget Reconciliation Act of 1989, P.L. 101-239, requires that any loan made insured, or

guaranteed under Part B be disbursed to students in two or more installments. The intent of the legislation is to prohibit students from receiving the full amount of the loan if they withdraw or drop out. However, NASFAA believes that this provision is especially burdensome and unnecessary for students who have borrowed the loan for a period of 90 days or less. In the interest of simplicity for students and institutions, we recommend that a single disbursement be permitted in these cases.

This modification also mandates that Stafford and SLS loans be disbursed according to payment periods similar to disbursement procedures in the Pell Grant Program. NASFAA believes that disbursing Stafford Loans by taking the loan period and dividing it by the payment periods, as in the Pell Grant Program, would simplify the administration of the Stafford Loan Program and would greatly benefit students by ensuring access to loan funds at the beginning of a payment period.

(21) We strongly recommend relieving first-year students attending institutions with cohort default rates under 20 percent from the financial burden of having their initial loan disbursement delayed. The Omnibus Budget Reconciliation Act of 1990, P.L. 101-508, amended the Higher Education Act to require a 30-day delay in the disbursement of loan proceeds to all first-time, first-year students as a cost saving measure. The intent of this legislation is to preclude first-year students, who are statistically more likely to drop out of a program, from receiving any loan funds if they drop out within the first 30 days of a program. NASFAA continues to oppose this legislation in principle because it places undue financial burdens on first-year, first-time students, many of whom must rely on their loan proceeds to pay for living expenses, books, etc. NASFAA points out that there are many safeguards in current law—including the multiple disbursement provision in Section 428G(a), and the elimination of Part B loan participation for institutions with high default rates—that have not yet been given adequate time to decrease default costs to the federal government. However, NASFAA recognizes that some additional restrictions may be necessary for institutions with higher

default rates. NASFAA believes that the suggested amendment would continue to achieve the desired effects of the Reconciliation legislation by targeting the requirement to "higher default risk" institutions, but it would also greatly benefit students attending institutions with lower default rates by allowing them access to their loan funds when they need it most.

(22) The current law allows no tolerance for an over-award in the Stafford, Perkins, or SLS loan programs. We suggest permitting a $500 tolerance for Stafford/Perkins/SLS overawards. In keeping with NASFAA's recommended overaward provision in the College Work-Study Program, we recommend extension of this necessary management tool to the Stafford, Perkins, and SLS programs.

(23) NASFAA believes that the cost of defaults rose so rapidly in the Stafford Loan Program due in large measure to the lack of administrative monies in the Department of Education for oversight activities and, to a lesser extent, the lack of training funds to improve the professional knowledge and experience of, among others, financial aid administrators. To remedy this situation NASFAA recommends reserving up to $25 million dollars from collections on defaulted loans for use by the Department to improve its administration of the loan programs. Allowable activities would include program reviews, audits, debt management programs, and training activities. An additional $5 million would be reserved to automatically fund Section 486 to provide necessary funds for training activities aimed at improving the knowledge and professional abilities of financial aid administrators among other allowable training projects. This recommendation already has been approved by the Education and Labor Committee in 1988 when H.R.4986 was cleared for floor action, but never was scheduled for debate.

(24) We recommend permitting institutions to act as lenders in the Part B loan programs by allowing institutions to lend if the institution's Stafford/SLS default rate is below 15 percent and if

the institution uses the majority of federal proceeds it receives as a result of its status as a GSL lender to provide need-based assistance to students. While recognizing that institutions incur some costs as a result of participation as a lender, NASFAA does not believe such lending activities should be used as an excess revenue mechanism for institutions. Therefore, NASFAA recommends that the majority of federal proceeds received by an institution as a result of participation as a Part B lender should be used to provide need-based grants to students.

(25) We suggest a change in the current definition of cohort default rate to conform to the following principles: (1) Default rates should be calculated and published for all participants in the student loan programs, including schools, lenders, and guaranty agencies; (2) Defaults should be based upon the originating organization rather than a subsequent organization; (3) Detailed information upon which default rates are based should be readily available to the organization at the time the information is published, and methods to correct errors should be in place prior to publication; (4) Along with default rates, information (using currently available information) about students served by that organization (by state, accrediting body, and institutional type) should be published (i.e. income by dependent and independent borrowers). (5) The computation of a cohort default rate should take into account cured loans. These recommendations taken as a whole both rationalize the calculation of the cohort default rate and provide needed default rate information to all parties to help reduce defaults. These recommendations further clarify the responsibility for institutional default rates and take into account loan collection activities in the determination of institutional cohort default rates.

(26) We strongly recommend requiring the Secretary to study the development of a comprehensive data base to include not only the recipients of all federal student loans under this Act, but also any additional information needed to eliminate the regulatory requirement for the Financial Aid Transcript.

NASFAA recommends this change for several reasons. The development of such a comprehensive data base requires careful consideration of the needs and the abilities of the various participants in the process. NASFAA recognizes that significant study has already taken place through the provisions in Sec. 485B, but does not believe that all information necessary to implement such a data base has been gathered. Further, in addition to collecting information about loans, NASFAA believes that such a data base should include all information necessary to eliminate the separate collection of a Financial Aid Transcript.

(27) Institutions should have explicit authority to withhold services, such as academic transcripts, from borrowers who default on their student loans. In some instances, state laws may control the release of, or access to, an individual's academic records. NASFAA believes that federal authority to address this issue is desirable. Such authorization would clarify institutional authority to take action to reduce defaults. It is understood that academic transcripts could be released once repayment on the defaulted loan(s) begins. NASFAA also believes that an exemption should be allowed if the institution determines the transcript would allow the individual to become employed in order to repay the loan or if extraordinary circumstances are involved and the withholding of the transcript would be highly unfair. This recommendation already has been approved by the Education and Labor Committee in 1988 when H.R.4986 was cleared for floor action, but never was scheduled for debate.

(28) NASFAA is aware of Congressional interest in a possible system of direct lending from the federal government. We have taken no position on this issue at this point, but NASFAA's Board of Directors has instructed our Reauthorization Task Force to study direct lending options and other alternatives and report back to the Board with its analysis and recommendations.

This concludes my testimony. NASFAA looks forward to working with you to ensure that student and parental credit needs are met to pay for college, that costs in the federal loan programs are reduced, that complexities are diminished, and that taxpayer monies are protected. I would be pleased to answer any questions you may have and thank you for the opportunity to testify.

Chairman **Ford**. Thank you. Jerry Murphy, Technical Institute of Illinois.

Mr. **Murphy**. Mr. Chairman and members of the subcommittee, good morning. My name is Gerald Murphy and I am the Director of Universal Technical Institute in Glendale Heights, Illinois. I also serve as a leader of Illinois Skills 2000, a coalition of concerned business, educators, community leaders and students working to explain the importance of Federal financial aid for students attending private career schools.

Our institution enrolls more than 600 students drawn from the metropolitan Chicago area, as well as downstate Illinois and the surrounding midwestern States. Our educational system comprises three campuses and has been in operation for over 25 years. Since our Illinois school opened in July of 1988, more than 75 percent of our students have received some form of Federal student aid.

This morning I'm also representing the Association of Independent Colleges and Schools and the National Association of Trade and Technical Schools. AICS and NATTS are the Nation's two largest organizations representing over 2,000 private career schools and colleges.

During the 1980s, the typical aid package saw a significant shift from grants to loans. NATTS and AICS firmly believe that the balance between grants and loans must be restored. I know that many students are reluctant to begin their education because they fear taking on large debt.

Although we would like to significantly increase the number and amount of Pell grants available, we also believe that Federal loan programs will continue to play a vital role in helping students pursue an education. We understand that budget limitations may not allow us to provide grants to all deserving students.

I'm pleased to have the opportunity to testify on the NATTS/AICS proposal to modify the student loan program. The student loan proposal, in part, is in part a comprehensive package to improve the entire student aid system. I ask that the committee consider these recommendations as part of the larger package. In the absence of the other pieces, one part of the package may not stand firmly on its own.

The NATTS and AICS loan proposal would make one significant change to the existing Stafford loan program; that is, the elimination of the in-school and grace period subsidies, which are the largest cost of the Stafford program.

In 1989, the Federal Government paid more than $1.8 billion in interest in grace period subsidies. Chart 1 of my written testimony shows the breakdown of costs incurred by the Federal Government under this program in 1988-89.

While the subsidy structure has effectively served to provide indirect grants to students, it is our belief that in the absence of significant increases in new dollars for Pell grants, such implicit grant dollars should be used to provide direct grants to students under the proposed Pell grant entitlement program.

How much do students currently benefit from the interest and grace period subsidies? For a student completing a baccalaureate program in 4 years who borrows the maximum Stafford loan amount for all 4 years, the implicit grant is about $760. The second chart attached to my testimony outlines this particular example.

The implicit grant increases the amount of indebtedness incurred by the student under subsidized programs, such as Perkins and Stafford. In addition, the implicit grant increases the longer the student remains in school; therefore, a student attending a 2 year program in a community college or in some private career schools receive a much smaller implicit grant than those students with higher loan balances and longer 4 year programs.

By transferring the implicit grant dollars from the Stafford loan program to the Pell grant program, students would have their need to borrow reduced up front, as opposed to receiving the implicit grant over the life of the loan.

The current loan program establishes risk for all parties: lenders have collections, due diligence and administrative risk; guaranty agencies have reduced reinsurance risk; the institutions and students have the risk of loss of loan access. If the current risk sharing allocation were modified to substantially increase risk, especially for the private sector, the current program would likely cease to operate because of the lack of access to private capital.

Under the current system, financial markets determine which students should have access to student loans. There is no doubt that the cost of making a small balance loan to a student in a short term program are greater for lender, servicer and a guaranty agency than loans made to students attending 4 year programs.

It is our belief that the program needs to be restructured to make social goals of the student loan program compatible with the needs of the financial markets to encourage participation of the private sector.

In an effort to make such goals compatible, we propose that the current subsidy structure be modified to reflect the true cost incurred by lenders. Specifically, we recommend that the committee consider modifying the interest rate paid to lenders for borrowers to permit a slightly higher rate for smaller balance short term loans and be paid at the current T-bill plus 3.25 for all other borrowers.

In an effort to simplify the loan program and application process for students, we also call for the continuation of the deferments for students, the development of a common student loan application and deferment forms, the ability for borrowers and married students to consolidate loans regardless of the loan size, and permit loans to be paid on a graduated repayment plan over a 10 year period.

In spite of the many statutory provisions intended to insure loan access for all students, regardless of the type of institution they attend, many students continue to face great difficulty and delays in obtaining student loans.

In order to insure access to students, we recommend that the current nondiscrimination provision be expanded to prohibit creditors from discriminating against students based on the type of institution or the length of program in which the student would like to enroll.

We also call upon the committee to develop a lender of last resort program to be included as part of the designated State guaranty program participation agreement. We suggest that any loans made under a lender of last resort program be dispersed 30 days after the application is submitted.

In addition, that all lenders making loans within a State be required to participate in the lender of last resort program, if requested by the guaranty agency, in a percentage equal to eight tenths of a point times the percentage of student loans they make in that particular State. This would spread the risk among all lenders participating.

Under the leadership of this committee, many provisions have been put into place to prevent student loan defaults. The 1986 reauthorization, the 1987 SLS legislation, the 1989 and 1990 budget reconciliation act all contained provisions which, over time, will reduce the cohort default rate.

In addition, many schools have implemented innovative default management plans that have already proven to be successful in reducing defaults. It is important that time be given to institutions and other parties in the loan process to incorporate these changes and evaluate their effectiveness.

NATTS and AICS schools have already seen the results of the default management initiative initiated back in 1986. Based on that success, my written testimony includes 13 additional recommendations that we believe will continue to reduce defaults.

I would also like to echo the testimony of several other witnesses this week who have recognized the importance of reducing student loan defaults through an increase in available Pell grant dollars and the adoption of a strong oversight system such as that proposed by NATTS and AICS.

The improved management and collection of student loans in vital to the continued success of this program. We offer nine additional recommendations included in my testimony designed to improve the operation of the student loan program by modifying the activities of lenders, guaranty agencies and institutions to focus our efforts on default prevention and service to students.

The collection and sharing of accurate information regarding student loans is vital to the efficient operation of the program. In order to make such information available, we propose that the Department of Education be required to expedite the development of the student loan data bank, and once developed, give all parties, including schools, access to that information.

While these recommendations will strengthen the student loan program, we urge the subcommittee to take further steps to protect the integrity of the entire student aid system. On May 21, Steven Blair presented this committee with a comprehensive set of recommendations designed to strengthen the triad and to provide additional safeguards and performance measures to ensure the careful oversight of the entire student aid system.

I ask that you give these recommendations your attention, as the failure of Congress to take steps to ensure program integrity could jeopardize the future of the entire student aid system.

I thank you for the opportunity to appear before this committee and would be happy to answer any questions you may have. Thank you.

[The prepared statement of Gerald Murphy follows:]

Testimony before the
Subcommittee on Postsecondary Education
Committee on Education and Labor
U.S. House of Representatives

by

Gerald Murphy, Director
Universal Technical Institute of Illinois
Glendale Heights, Illinois

June 6, 1991 -- 9:30 a.m.
2175 Rayburn House Office Building

Mr. Chairman and members of the Subcommittee, good morning. My name is Gerald Murphy and I am the Director of the Universal Technical Institute in Glendale Heights, Illinois. I also serve as a leader of Illinois Skills 2000 -- a coalition of concerned business people, educators, community leaders and students working to explain the importance of federal financial aid for students attending private career schools.

Universal Technical Institute enrolls more than 600 students drawn from metropolitan Chicago and the state of Illinois, as well as the surrounding midwestern states. Our institution educates and trains students in automotive and diesel technology, and heating and air conditioning technology. Since our school opened in July 1988, more than 75 percent of our students have received some form of federal student aid. The percentages at our school are fairly representative of what is happening at schools across the United States.

This morning I am also representing the Association of Independent Colleges and Schools (AICS) and the National Association of Trades and Technical Schools (NATTS). AICS and NATTS are the nation's two largest organizations representing private career schools and colleges. They represent 2,200 institutions educating nearly 1.5 million students in 130 different career-specific fields.

Many of our students rely on grants and loans in order to finance their education. Fortunately, the Higher Education Act programs have enabled people with few economic resources to obtain an education.

Student loans play a significant role in financing postsecondary education. In 1986, 60 percent of students attending private career schools received some type of loan assistance to help finance their education. While this number has declined as some schools have lost eligibility to accept student loans, it is clear that student loans provide access to many students attending private career schools.

As you know, during the 1980s the typical aid package saw a significant shift from grants to loans. I firmly believe that we must restore a better balance between grants and loans. I know that many students (and their parents) are reluctant to begin their education because they fear taking on so many loans. Under today's system, even the most economically disadvantaged students may leave school under a crushing burden of debt.

Although we would like to significantly increase the number and amount of Pell Grants available, we also believe that federal loan programs will continue will play a vital role in helping students pursue an education. We understand that budget limitations will not allow us to provide grants to all deserving students. And we know that many students can be well served through the guaranteed student loan program.

AICS/NATTS LOAN PROPOSAL

AICS and NATTS have submitted a legislative proposal to this Committee and I would like to explain their recommendations. In general, the proposal would make some significant changes to simplify the student loan programs and ensure that more students had access to this kind of assistance. Let me give you a point-by-point review of our loan proposal. It also contains specific provisions to help reduce student loan defaults and improve the management of these programs.

A. Structure and Subsidies

The largest cost of the Stafford program currently is the in-school and grace-period subsidy provided to the student. In 1988-1989, more than $1.8 billion was spent by the federal government on in-school and grace-period payments. In the same year, student loan defaults less collections cost the federal government $1.25 billion. The interest and grace-period payments are so significant because of the number of students who take out large balance loans and remain in school for a longer period of time. The attached chart shows the breakdown of expenditures by the federal government for 1988-1989. The savings found from reducing student subsidies would be transferred to the Pell Grant program. Assuming the current general structure of the loan delivery system remains the same or similar, then we should significantly simplify that system by:

- Permitting borrowing equal to the borrower's maximum federal aid eligibility minus the sum of the Pell Grant award and the Work-Study and Perkins Campus-based award as long as this

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amount does not exceed the loan limit for that student's year in school.

- Eliminating the current Stafford Loan in-school and grace-period subsidies and special allowance payments, and transferring the savings to the Pell Grant program.

B. Eligibility, Terms and Conditions

The current loan program establishes risk for all parties in the program -- the lenders have collection, due diligence and administrative risk; the guaranty agencies have reduced reinsurance risk; and institutions and students have the risk of loss of loan access. If the current risk-sharing allocation were modified to substantially increase risk, especially for the private sector participants, the current program would likely cease to operate because of the lack of access to private capital.

Under the current system, the financial markets determine which students should have access to student loans. There is no doubt that the costs of making a small balance loan to a student in a short-term program are greater for a lender, servicer and a guaranty agency than loans made to students attending four-year programs at traditional institutions. It is clear that the program needs to be restructured to make the social goals of a student loan program compatible with the needs of the financial markets. We recommend doing this by:

- Making all students enrolled in programs of one year or more eligible to receive a Stafford Loan to the extent it did not exceed cost of attendance or $12,000 when combined with work-study and other types of campus- or state-based assistance (or higher depending on the year of attendance) minus the student's Pell Grant award, whichever is less.

- Modify the interest rate paid to lenders by borrowers to be:

  a. For the in-school period, Treasury-bill(T-bill) plus 3.5 percent for borrowers enrolled in programs of 2 years or less and T-bill plus 3.25 percent for all other borrowers;

  b. For the repayment period, T-bill plus 3.5 percent for borrowers with loan balances of $10,000 or less and T-bill plus 3.25 percent for all other borrowers.

- Accrue and capitalize all in-school and grace period interest. For a student completing a four-year program in four years and borrowing the maximum amount from the Stafford Loan Program in all four years, the accrued in-school and grace-period interest would result in an additional $759 in indebtedness. However, this number would most likely be significantly lower if the NATTS/AICS Pell Grant proposal were adopted as the student would have their need to borrow reduced if Pell Grant dollars were available.

- Maintain the current statutory deferments, especially those related to parental leave, unemployment and mothers with preschool-age children.

- Mandate a common deferment form.

- Permit borrowers and married students to consolidate loans, regardless of the size of the loan.

- Permit all loans to be repaid on a graduated repayment plan, the length of which would be the same as under normal repayment plans: e.g., 10 years.

- Establish loan repayment periods of up to 10 years with a minimum monthly payment of $50 or the monthly interest accrued, whichever is greater.

- Eliminate the Income Contingent Program.

C. Access

In spite of the many statutory provisions intended to ensure loan access for all students regardless of the type of institution they attend, many students face great difficulty and delays in obtaining a student loan or cannot get a loan at all.

- Expand the non-discrimination provision for creditors to prohibit discrimination based on the type of institution, tax status, or length of the program in which the student is enrolled.

- Develop a lender-of-last-resort program as a part of the designated state guarantor program participation agreement.

  (a) Require that any loans made under a lender-of-last-resort program be disbursed 30 days after the application is submitted by the institution (sec. 428).

  (b) In the event that more than 10 borrowers attending the same institution are forced to use lender-of-last-resort services, the institution will be certified as an institution in need of lender-of-last-resort services, and, as a result, borrowers would not be required to seek "denials" from lenders, and the institution may act on behalf of the students.

  (c) Require all lenders making loans within a state to participate in the lender-of-last-resort program, if requested by the designated guaranty agency, in a percentage equal to 0.8x the percentage of student loans they make in that state.

- o Require the development of a common student loan application form.
- o Fair and equitable default rates should be calculated using accurate data for all participants in the Guaranteed Student Loan programs.
- o Net loan default volume, after all collections are made, should be used as the basis for institutional eligibility and limit, suspend and terminate (LS&T) actions.

D. Default Prevention

The 1986 Reauthorization legislation, the 1987 SLS legislation, and the 1989 and 1990 reconciliation legislation all contain provisions which, over time, will reduce the cohort default rate. In addition, many schools have implemented innovative default management plans that have already proven to be successful in reducing defaults. It is important that time be given to institutions and other parties in the loan process to incorporate these changes and evaluate their effectiveness:

The following recommendations are drawn from the experience of NATTS and AICS institutions through the Default Management Initiative that was put into place by our schools more than four years ago. All of these recommendations were designed to reduce defaults by improving communication and placing greater emphasis on default prevention.

- o Require lenders to report delinquent loans to credit bureaus at 90 days of delinquency.
- o Authorize lenders and servicers to place borrowers in deferment status based on information provided by borrowers in order to prevent technical default. If the borrower is subsequently found to be ineligible for a requested deferment, the borrower shall be returned to repayment status and the incorrectly deferred principal payments and interest shall be capitalized.
- o Limit the aggregate borrowing of a student in a calendar year to the total aggregate dollar amount for which the student is eligible.
- o Require the state guaranty agencies to use skip tracing tools to trace defaulters, if necessary, by limited federal preempting of state laws which would prohibit access to such records. Available records would include motor vehicle

department records, state tax, labor, employment registers,unemployment commissions, licensing bodies and welfare offices.

- Require guaranty agencies to periodically provide institutions with lists of defaulted borrowers so that institutions have the opportunity to provide additional information that could help locate the student.

- Require the collection of additional information on borrowers, including family personal references and driver's license numbers, at the time of the application for the loan and update such information, if necessary, at the exit interview.

- Authorize institutions to withhold the academic transcripts of borrowers who default on any Title IV loan. Pre-empt state law where necessary.

- Require lenders and servicers to notify the institution of the first past due listing (60 days)and the final demand letter.

- Require guaranty agencies to provide delinquency lists to institutions and permit institutions to comment on the accuracy of the lists prior to claims being filed by the guaranty agency.

- Create an incentive for employers to repay student loans on behalf of their employees.

- Provide up to $25 million from collections on defaulted loans to fund Department of Education default activities and fund at $5 million the training section of the Higher Education Act.

- Establish in law the criteria upon which the Secretarial waiver may be granted for the loss of eligibility based on default triggers, to include low-income students, positive outcomes, measures(completion and placement rates), economic and employment conditions, and a decline in the institution's cohort default rate experience or the evidence that a high default rate is the result of the inadequate servicing of loans.

- Make PLUS loans co-payable to the student and the institution.

E. Management and Collection

The recent report of the Senate Permanent Investigations Subcommittee and reports by the Inspector General at the

Department of Education and the General Accounting Office have commented on the critical need to improve the management of the student loan program. NATTS and AICS share many of these concerns regarding program management that were raised in these reports and offer the following recommendations to improve program management.

- o Require the guaranty agency to remit collections owed to the Department of Education within 30 days of the receipt of funds by the agency.
- o Require all guaranty agencies and lenders/holders to report data based on standardized definitions and forms.
- o Require that any limitation, suspension and termination (LS&T) action taken against an institution be based on non-discriminatory standards, including prohibitions against LS&T actions based on type, control, tax status, or accreditation of the institution.
- o Permit institutions to purchase supplemental collection services from lenders, guaranty agencies, secondary markets, or servicers. Fees for such services should be based on administrative costs of such services.
- o Permit the charging of a higher insurance fee (up to 5 percent) for those loans which are funded through a lender-of-last-resort program. However,the rate charged must be experience-based and not reflect the type, control, or tax status of the institution.
- o Eliminate the current system of due diligence procedures and develop performance-based criteria and positive incentives for default prevention and loan collection.
- o Develop standards to require that guaranty agencies operate on an actuarially sound basis and develop procedures to assist the Department of Education in identifying potentially insolvent guaranty agencies.
- o Require the Department of Education to develop a specific plan of action to be taken in the event that a guaranty agency is unable to continue to operate and mandate that such a plan will be implemented within 15 days of notice of a guaranty agency's inability to operate.
- o Provide special incentives to guaranty agencies to serve high-risk student populations by modifying the current method of calculating federal reinsurance payments.

F. Information, Collection and Use

The sharing of accurate information regarding a student's loan is vital to the efficient operation of the student loan program. In order to make such information available to both institutions and students in a timely manner, NATTS and AICS propose the following:

- Expedite the development of the Student Loan Data Bank.
- Permit institutions to have access to these data.

G. Parent Loans for Undergraduate Students (PLUS)

The PLUS loan program has provided many parents with the liquidity to finance a postsecondary education for their children. We offer the following recommendations to improve this successful program:

- Require all PLUS loans to be co-payable to the parent and the institution.
- Require multiple disbursement of PLUS loans.
- Increase PLUS loan limits to $20,000 per year with the aggregate maximum of $100,000.

CONCLUSION

That is a detailed explanation of the loan portion of the AICS and NATTS legislative proposal. This proposal should be considered in the context of all our reforms. I believe they provide a good framework for vastly improving the current loan system.

While these recommendations will strengthen the student loan program, NATTS and AICS urge the Subcommittee to take further steps to protect the integrity of the entire student aid system. On May 21, Stephen Blair, President of NATTS presented this subcommittee with a comprehensive set of recommendations to strengthen the triad and to provide additional safeguards and performance measures to ensure oversight of the entire system. I ask that you give these recommendations careful attention as the failure of the Congress to take steps to ensure program integrity could jeopardize the future of the entire student aid system.

Mr. Chairman. For millions of Americans, grants, loans, and other types of financial assistance have been a necessary component in obtaining a postsecondary education. For the past 25 years, the Higher Education Act has afforded that opportunity to individuals -- opening doors so that they have a chance at pursue their version of the American dream.

As you consider the reauthorization of the Higher Education Act, I also hope you will recognize the vital role these programs play in determining the quality of our nation's workforce. In order to ensure that a skilled and productive workforce leads our country into the 21st century, access to solid and credible postsecondary education must be available. We need to devote our resources to ensuring that we have the kind of skilled and competitive workforce our economy needs to remain competitive.

Private career colleges and schools play a significant role in the education of the American workforce. Our schools provide the type of job-specific, technical education that American businesses demand.

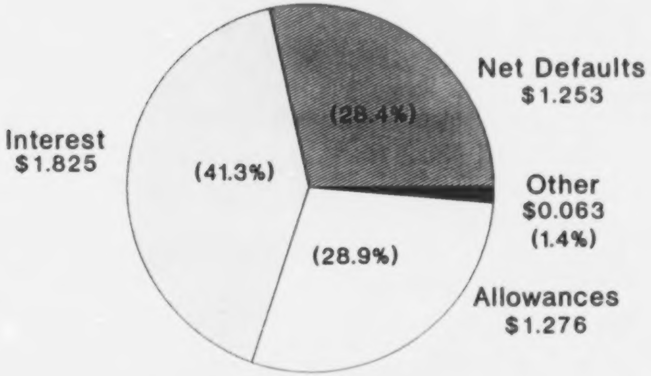
I urge you to think about the success stories you have heard, the productive members of your communities you have met, and the very satisfied businesses who have all benefited by the availability of student aid for those pursuing postsecondary educations.

The significant decisions you make in the months ahead will determine whether future generations of students will enjoy the same educational opportunities as the last and whether our nation has the kind of skilled workforce it needs to remain competitive.

# # #

Guaranteed Student Loan Costs
Dollars and Percent
1988-1989

Dollars (Billions)



Total Costs=$4.417 Billion

Source: U.S. Department of Education, "FY 1989 Guaranteed Student Loan Programs Book."

Stafford Loan Program Cost
Four-Year Undergraduate

Year	Amount Borrowed	Interest Subsidy*	Origination Fee**	Total Cost of Subsidy
1	$ 2,625	$ 262.50	$ 131.25	$ 131.25
2	2,625	525.00	131.25	393.75
3	4,000	925.00	200.00	725.00
4	4,000	1,325.00	200.00	1,125.00
6 month grace	---	662.50	---	662.50
Total	$13,250	$3,700.00	$ 662.50	$3,037.50

Total Subsidy = $759 per year in school.

* Assumed to be 10%

** 5% of amount borrowed

Chairman FORD. Thank you. Mr. Donald Grigley, Connecticut National Bank of Hartford, Connecticut.

Mr. GRIGLEY. Good morning, Mr. Chairman and members of the subcommittee. My name is Donald Grigley. I'm a Senior Vice President at Connecticut National Bank in Hartford, Connecticut. I'm also a chairman of the American Bankers Association Consumer Credit Executive Committee.

I'm pleased to testify before the subcommittee on behalf of the ABA regarding the guaranteed student loan programs. The ABA is the National trade association representing commercial banks of all sizes with combined assets of 95 percent of the industry.

Under the GSL programs, lenders currently play the role of making private funds available to the Nation's students. Public reliance on the private lending industry to fund the burgeoning cost of postsecondary education results in an effective and cost efficient program.

The ABA believes all parties concur on the need for Pell grant awards to the neediest recipients. The challenge we all now face is to find some means of fulfilling the Pell grant program. The need for fulfilling this goal goes beyond the access issue.

Many of today's problems in the GSL programs, especially high default rates, can be tied to the fact that too many students who once would have been eligible for grants must now rely upon debt financing for most of their educational costs. An overwhelming debt burden can lead students to either leave school prematurely or, for those students who remain, bear the burden of further debt assumption.

The ABA is sensitive to the difficulties associated with the current mix of grants versus loans and looks forward to working with Congress to ultimately cure the problem of high defaults in a manner that is fair to all parties.

Despite being a little rough around the edges, the GSL programs are sound. The ABA strongly supports the continued partnership of private funding and public oversight. While the default problem continues, the ABA believes many recent initiatives by the Department of Education have and will continue to favorably address this problem.

In the meantime, attention to the default issue would be better directed at program simplification. There is also room for improvement to GSL program administration. Many lenders have left the program because of low profitability from collection costs associated with high default rates and a rigid regulatory environment.

To address these problems, legislative solutions are necessary. First and foremost in ABA's view is the financial stability of guaranty agencies. The first goal is to minimize the need for future innovation to shore up guaranty agencies' financial soundness.

A periodic data collection and dissemination program is necessary, whereby cash flows and projected default claims at all guaranty agencies would be available to GSL program lenders.

A formal contingency plan also needs to be adopted to address financial problems at guaranty agencies at the point they become known and if they persist, at the point that the agency nears insolvency.

The ABA's second concern is with lender due diligence requirements and their enforcement. Low program lender profitability is partly due to the costly procedures lenders must undertake to comply with rigid and onerous due diligence requirements. Lenders may also lose the full guaranty simply for minor technical violations. This problem should be addressed not for the purpose of boosting lender profits, but to avail program participation to all lenders.

The department's due diligence and other requirements need to be modernized. Only lenders consistently failing to perform adequate due diligence should be subjected to the current system of enforcement. A substantial compliance approach needs to be adopted for those lenders demonstrating suitable due diligence performance.

Lender performance could continue to be monitored at the guaranty agency level under standardized guidelines, with the appropriate enforcement method being exercised by the department.

My final recommendation to the subcommittee would be for increased movement towards standardized loan application and other forms, as well as electronic storage and communication of program data at the guaranty agency and department level to reduce administrative costs and increase program efficiency.

I thank you for the opportunity to testify. I'd be happy to answer any questions at the appropriate time.

[The prepared statement of Donald A. Grigley follows:]

STATEMENT OF
DONALD W. GRIGLEY
SENIOR VICE PRESIDENT,
CONNECTICUT NATIONAL BANK
HARTFORD, CONNECTICUT

ON BEHALF OF
THE AMERICAN BANKERS ASSOCIATION

BEFORE THE
HOUSE SUBCOMMITTEE ON POSTSECONDARY EDUCATION

REGARDING REAUTHORIZATION OF THE
HIGHER EDUCATION ACT OF 1965

JUNE 6, 1991

STATEMENT OF THE AMERICAN BANKERS ASSOCIATION
REGARDING REAUTHORIZATION OF THE HIGHER EDUCATION ACT OF 1965
SUBMITTED TO THE
HOUSE SUBCOMMITTEE ON POSTSECONDARY EDUCATION
JUNE 6, 1991

Mr. Chairman and members of the Subcommittee, my name is Donald W. Grigley. I am Senior Vice President of Connecticut National Bank in Hartford, Connecticut. I also chair the American Bankers Association's (ABA) Consumer Credit Executive Committee. I am pleased to testify before the Subcommittee today on behalf of the ABA regarding the Guaranteed Student Loan (GSL) programs and reauthorization of the Higher Education Act of 1965 (HEA). The ABA welcomes this opportunity to underscore the value the commercial banking industry brings to the GSL programs governed by Title IV of the Act.

The ABA is the nati[illegible] trade association representing commercial banks of all sizes, types, and locations. The combined assets of our membership represents approximately 95 percent of the industry total.

OVERVIEW

Under the GSL programs, lenders currently play the fundamental role of making private funds available to the nation's students, while also bringing to bear their applied experience in the origination and servicing of these loans. Public reliance on the private lending industry to fund the burgeoning costs of postsecondary education results in an effective and cost efficient program. Reliance on public funds to support loans to students is held to a minimum since these funds come into play only as:

- special allowances, to minimize the interest burden on student borrowers while maintaining a market rate on the programs to ensure continued availability and efficient management; and,
- reinsurance of uncollectible GSLs in those cases where a student borrower cannot or will not repay a GSL.

PELL GRANTS

ABA believes all parties -- students, parents, educators, financial aid administrators and those private lenders who fund credits for a college education -- concur on the need for Pell Grant awards to the neediest recipients. Both the number of eligible students and families, and the maximum grant awarded, need to be reviewed in light of the erosion that has taken place since the early-1980s with respect to this fundamental student financial aid program.

The erosion in the Pell Grant program was largely spurred by federal budgetary constraints and continued increases in postsecondary education costs. The challenge we now face is to find some means of fulfilling the goals of Pell Grant aid -- providing access to a college education for qualified U.S. citizens who cannot meet the costs of attending a college of their choice through family and individual contributions alone.

The need for fulfilling this goal goes beyond the access issue. Many of today's problems in the GSL programs, especially high default rates, can be tied to the fact that too many students who once would have been eligible for grants must now rely upon debt financing for most of their education costs. An overwhelming debt burden can lead students to leave school prematurely because they can no longer justify the assumption of new debt. In most cases, such students are not qualified for positions in the career of their choice and thus cannot afford to repay education loans that carried them only partially toward their educational goals. Moreover, those students who remain in school bear the burden of further debt assumption and often find repayment difficult because of the large amount owed following graduation.

ABA is sensitive to the difficulties associated with the current mix of grants versus loans and looks forward to working with Congress to ultimately cure the problem of high defaults in a manner that is fair to all parties.

GUARANTEED STUDENT LOANS

ABA strongly supports the continued partnership of private funding and public oversight for the GSL programs. While the default problem continues, ABA believes recent initiatives by the Department of Education (the "Department") have and will continue to favorably address this problem. Until future default rates begin to reflect the numerous reforms already made, attention to the default issue would be better directed at program simplification and enhanced access to grants in the first half of the eligible student's educational program.

On the other hand, there is room for much improvement to GSL program administration. Net defaults, after collection, remain relatively constant in the 10-11 percent range. Nonetheless, with a greater reliance on loans and with increasing loan amounts, aggregate default costs represent an increasing proportion of overall program costs to the Department. Moreover, many lenders have left the programs because of the low profitability from collection costs associated with high gross default rates and the rigid regulatory environment in which the programs operate.

Finally, to alleviate much of the confusion that often accompanies new regulations, it may be beneficial for the rulemaking process if the Department consulted with lenders, guarantors, secondary markets and other program participants in advance.

To address these problems, legislative solutions are necessary.

1. **Financial Stability of Guaranty Agencies and Third-Party Servicers.** The demise of the Higher Education Assistance Foundation ("HEAF") took many of the participants in the GSL programs by surprise. While HEAF's problems with high portfolio default rates were well known, the extent to which these rates hampered HEAF's financial position was not as clear. While the Department of Education dealt with the HEAF problem in a way favorable to the long-term stability of the GSL guarantee system, this intervention was an ad hoc approach that cannot necessarily be relied upon if other guaranty agencies encounter similar financial problems.

   The first goal is to minimize the need for future Department intervention to shore up a guaranty agency's financial soundness by improved monitoring and oversight. A periodic data collection and dissemination program is necessary whereby cash flows and projected default claims at all guaranty agencies would be available to GSL program lenders for their ongoing evaluation of their guarantors' financial stability.

Second, a formal contingency plan needs to be adopted by the Department to address financial problems at guarantee agencies at the point they become known and, if they persist, at the point the agency nears insolvency. The risk sharing scheme proposed by the Bush Administration in its 1992 Budget addresses the issue of full reinsurance of lenders but does not propose a resolution mechanism beyond simply authorizing the Department to assume control of an insolvent agency. Efficient and sound program management also needs to address third-party servicers. The need for periodic, certified audits of servicer operations, with the results reported to the Department and made available to lenders, should be evaluated. Such a formalized approach could supersede the current ad hoc system of reviews conducted on behalf of individual lenders, guarantors, and secondary markets.

2. **Improved Lender Due Diligence Procedures.** Low program lender profitability, in spite of the special allowance paid on GSLs by the Department, is largely due to the costly procedures lenders must undertake to comply with the Department's rigid and onerous collection due diligence requirements. This should be addressed not for the purpose of boosting lender profits, but to assure continued program participation by a broad cross-section of lenders.

   To ensure suitable levels of lender presence in the GSL programs, the Department's due diligence and other requirements need to be modernized so that they reflect prevailing practices in other forms of retail lending without compromising the level of protection the federal government requires to enforce its reinsurance of GSLs. Only lenders running high default rates or consistently failing to perform adequate due diligence (as measured against the Department's recently proposed changes to the regulations [55 *Federal Register* 24]), should be subjected to rigorous due diligence regulations and enforcement. A "substantial compliance" approach needs to be adopted for those lenders experiencing manageable default rates and/or demonstrating suitable due diligence performance. Lender performance and default rates could continue to be monitored at the guaranty agency level, under standardized guidelines, with the appropriate enforcement method being exercised by the Department.

3. **Streamlined GSL Program Regulations.** The regulations, statutes, and policy initiatives governing the GSL programs have become needlessly duplicative and require consolidation. Since its adoption in 1965, the HEA has undergone numerous

reauthorizations and other statutory changes. Moreover, the Department only adopts the implementing regulations several years after becoming law. Rarely have superfluous or conflicting provisions been deleted by law or regulation on a timely basis when new provisions were added. Consequently, interpreting the GSL program has become a cottage industry of its own -- an extra, costly, and unnecessary new burden.

An example of the complexity of the existing statute is the provision of 11 different deferment categories when 3 would suffice (e.g.; military or other eligible government service; returning to school; and a catch-all hardship class). This and other redundant provisions of the programs could be reconciled without compromising their intent.

Increased movement towards standardized loan application and other forms, as well as electronic storage and communication of program data at the guaranty agency and Department level, would also reduce administrative costs and increase program efficiency.

4. **Further Default Reduction Measures.** ABA commends the awareness of the Department and Congress of the problem posed by high program default rates, and the resultant steps taken in the past several years designed to address this problem directly. These steps are only just beginning to take effect and should result soon in an easing of gross default rates. However, more needs to be done to improve the Department's ability to collect on defaults.

The Administration's 1992 Budget proposes to expand the IRS' program to offset uncollected GSL debt against tax refunds; extend wage-garnishment of private-sector employees; repeal the statute of limitations for the collection of GSL defaults; and several other promising initiatives. Such proposals should be considered to the extent they address the problem of student borrowers in default who nonetheless have the capacity to provide repayment.

Finally, despite the many promising proposals in the Administration's reauthorization package, ABA questions the effectiveness of the proposal to require a credit check on all student applicants age 21 or older. This requirement is not likely to yield any significant reduction in defaults since few students, even at age 21, would have meaningful credit histories. If such a requirement is adopted, however, age 23 would be a better age at which to trigger a credit check. Furthermore, guidance as to what constitutes a poor credit history requiring a cosigner of the loan would be necessary from the Department.

With respect to the Administration's proposed reduction of the special allowance rate paid to lenders experiencing cohort default rates greater than 20 percent, more specificity as to how each lender's cohort default rate would be measured is needed before ABA can fully evaluate the effectiveness of this proposal.

5. **Student Eligibility and School Reforms.** Effective reform of the GSL programs will recognize the fact that students from lower income groups simply are not always in a position to commence repayment of GSL obligations immediately after their education is completed. In the past, these students were eligible for Pell Grants, but access to this program has been severely limited in recent years.

If it becomes feasible to expand access to Pell Grants, there should be a concurrent change in the eligibility requirements for GSLs. Eligibility in the first half of a student's education program should be determined by income "floors" and "ceilings." Potential borrowers with income levels below the "floor" could be eligible for grants; those with incomes between the "floor" and "ceiling" would be eligible for GSLs. Eligible borrowers' loan limits would be determined by their need analysis. In the first half, a heavier reliance on grant aid over loan aid for eligible students would limit pressure on the GSL programs from defaults attributable to students not completing their chosen course of study.

Finally, abuses of the Title IV aid programs by postsecondary schools need to be addressed. Certification criteria for schools' participation in the programs need to be reviewed and, where necessary, revised. All sectors of schools should be held accountable to a uniform set of criteria at the federal level. Those schools in violation of the uniform criteria should face broadened and speedier limitation, suspension, and termination procedures.

Chairman **Ford**. Thank you very much. Mr. Farrell, Mr. Hough notes in his testimony that, and I quote in part, "Ultimately the guaranteed student loan program is a Federal program which certifies schools as eligible for participation in the program. This includes a certification of the basic financial soundness of an institution."

Therefore, his question in his prepared testimony was, "Shouldn't it be the Federal Government's responsibility for the loan debts of students if the school goes bankrupt?"

Do you care to react to that, or would you like to take it under advisement and react to it?

Mr. **Farrell**. Thank you, Mr. Chairman. I'll react in the overview of the program. I come to this job with a perspective not influenced by the development of the program. I've learned a lot by listening to your committee and your staff people and other organizations that have been associated with this program.

If I could place a responsibility for the problems that the program has encountered, I would place them with the Department of Education and I would place them with the other organizations that are represented here at this table.

If there's anything clear to me, it's that much of the risk of this program has been borne by the Department of Education and the Federal Government, ultimately; however, in the evolution of the program over the years in an effort to respond to and encourage this program and help all of the contributing organizations provide an effective program, I think some of the organizations that are involved have stepped back some from their own responsibility for the results.

I can't really turn the clock back and start the program over. I think, overall, the program is an effective one, a viable one, one that clearly many people think have serious problems. I think those can be fixed; I think they will be fixed.

But the way we get the best results is if all of the organizations that have done very well under this program contribute to the fixing. The students are the ultimate recipient and the ultimate consumer in this program, and I've been struck by the lack of their input and participation in the system. We're going to do something about that also so that we hear more of the students' opinions about the programs in which they participate.

Chairman **Ford**. Well, that's a good response in a general way to the problems of the program, but Mr. Hough's question was a more direct one. A school goes broke. It's been certified to receive student aid and it goes broke because there's a pattern indicating that its ratio of assets to liabilities is not healthy.

Should the student bear the burden of that bankruptcy or failure, or who would we look to? Under the regulations of the department, you have the right to look into all of those things, even to require performance bonds. And the question is if we're to correct that specific situation, who will we look to, if not to the department?

No one else has the right to look at an institution's financial viability in terms of what that might mean and its ability to fulfill its contract with a student who has paid tuition. The lender can't do that; the guaranty agency can't do that; the secondary market can't do that.

We've had a lot of talk up until this point about empowering the department to more stringently enforce accreditation as such, but only one element of accreditation is financial viability. And you have in place a substantial body of administrative rules dealing with the requirements to show financial viability, and yet we have these failures occur, in part, we're told, because of the tightening we've done in recent years. We were told that we put a number of propriety schools out of business last year that may number in the hundreds because of the things like the SLS changes we made in reconciliation.

But who should be the cop in the block in this whole process that sees this failure coming and acts to protect the interest of the students even if it does occur?

Mr. FARRELL. I think, clearly, the ultimate responsibility lies with the Department of Education.

Chairman FORD. Now, this is not in any way intended as a criticism of you or the Secretary. We're not asking you to pay for your father's sins here, but we are talking about where we're going from here. I've been looking at this for some time. I think I may have talked to Mr. Hough about this before.

But the thing is when we look back, the department has let its muscles get kind of soft over there and there are tools already there without major changes in the law that could be used. I assume from what you and the Secretary have both said before this committee that you intend to start working out in the gym until those muscles are working again.

Is this one of the areas that you can put some attention on?

Mr. FARRELL. You bet, sir. We're a little flabby and I might add that most of the organizations represented at this table are a little flabby. We could all do with some additional workouts.

We're focused on the problem of students and the result that occurs for them when they're, perhaps, lured into a program that isn't really going to provide what they hope that it will, a quality education. And what they get instead is a program that encourages them to drop out fairly soon after they join it.

That's what a lot of our initiatives here are designed to do. That's hopefully the result that we'll bring about when we finish implementing the 13 recommendations that were put forward by the Secretary and the Office of Management and Budget.

We're also giving attention to the upcoming default initiative and its impact upon students, and are working on programs that involve cooperation from other schools in that area.

So it's a program where, clearly, I think the department's got good leadership now, strong leadership. And I think we have to assume our role as a leader in education.

Chairman FORD. I have other people who want to ask questions, and I'll return later.

Mr. Andrews.

Mr. ANDREWS. Thank you, Mr. Chairman. I thank the members of the panel for their testimony this morning. Mr. Banks, I want to explore with you for a couple minutes a proposal that's out there that would substantially replace banks as lenders and make the government the primary source of lending in guaranteed student loan programs.

I know that your association president has been quoted as being critical of the program. I have an article from January 8th of this year in which—is it Joe Belue? Is that the president of your organization?

Mr. BANKS. Correct.

Mr. ANDREWS. He's quoted as saying that the plan to replace the banks with the Federal Government as the source of the loans, make the Federal Government the lender, was "naive and misleading, as well as unsound." He's quoted as saying it will actually increase the complexity of the student loan program because bank loans would be outstanding for as long as a decade while the new system was also in place.

I don't know what I think about that proposal, and I thought maybe you could help me understand it a little bit better this morning.

First of all, you note that your bank, Chemical Bank, has $900 million outstanding in guaranteed student loans. Could you provide for us an estimate of how much the bank collected in fees in the course of making that $900 million of loans?

Mr. BANKS. Well, two answers to this. On the first part of your question, on June 12th I understand your subcommittee will be having full hearings. But in regard to that question, I think the important thing in considering this is what is the outcome to the student.

And what is being proposed here are multiple proposals from various organizations. All the different groups within Washington really haven't come together and put one straightforward proposal together.

So there isn't one simple answer to this: however, whatever direct lending proposal was adopted would require a huge amount of advance time and systems work either on the Department of Education and outside servicer or requiring schools or the Social Security system to implement it.

And the thing I worry about from a student's point of view is if it takes 3 or 4 or 5 years to put those systems in place and, in fact, reauthorization is signed within 14 or 15 months, I think it could cause a problems where students may not have loan availability until the systems come on line. But, again, that's a simple answer, a short answer.

Mr. ANDREWS. I appreciate those concerns. I think they're all well founded. But do you know or could you provide us with how much Chemical Bank has made in fees on the $900 million in loans?

Mr. BANKS. Well, one point on the fees. The banks don't actually charge a fee on the program; we deduct the proceeds from the loans. Five percent is passed on to the Federal Government, and 3 percent is passed on to the States. We don't actually take a fee out of the loan for the bank itself.

Mr. ANDREWS. The bank does this as a charitable venture?

Mr. BANKS. No. We earn monies on it through the interest paid, meaning where our yield is T-bill plus three and a quarter. Our cost of funds is anywhere from T-bill plus 80 to T-bill plus 120, depending on the capital markets. And we have operating expenses.

Mr. **Andrews**. So, typically, the crux of the transaction is in the money management, the cash management side, which is the way banks typically operate.

And you're saying, typically, that there's a spread of 80 to 120 basis points for your cost of acquiring these funds versus what the Federal Government does. Is that right?

Mr. **Banks**. Correct. We pay, obviously, higher than the Federal Government. The Federal Government is, obviously, the ultimate credit.

Mr. **Andrews**. If that were the case, wouldn't it also be true, then, that for every billion dollars that's borrowed in the program, that anywhere from $80 million to $120 million in savings would occur by borrowing the money directly through the Federal Government instead of through the banks?

Mr. **Banks**. I think the proportions would shift. Obviously, from the point of raising public capital, the public capital does have a cost above the Federal Government's borrowing powers because they are the Federal Government. I think the operating side, or operating the program, becomes the thing that's problematic.

And to my knowledge, I haven't seen anything out of CBO or OMB stating what the actual cost of servicing this program is. And I think that's the thing we're waiting for, to see some better cash flow estimates done.

Mr. **Andrews**. So that if this program were not to make sense from an economic point of view, it would be for the reason that the increased administrative costs would more than consume the interest rate savings and the cost of acquiring money?

Mr. **Banks**. That's correct.

Mr. **Andrews**. Do you think it's generally true that the private sector could do a better job at administering the portfolio and administering the fund than the department could? Would you agree with that statement?

Mr. **Banks**. You mean under the current program?

Mr. **Andrews**. Yes.

Mr. **Banks**. I believe in the private sector that the private sector is currently doing an excellent job in many ways and doing a poor job in certain areas. But I think we know the system we're dealing with, and to put students at risk at this time would be dangerous.

Mr. **Andrews**. If that were the case, that there are savings in the magnitude of $80 million to $120 million for each billion borrowed—I think my numbers are right.

Mr. **Banks**. A savings of 80 basis points would be $8 million per billion.

Mr. **Andrews**. $8 million per——

Mr. **Banks**. Billion.

Mr. **Andrews**. Per billion. No, I'm not sure if that's the right magnitude. Regardless of the right magnitude, couldn't we address the problem of the higher administrative cost by contracting out the money management, collection and administrative side?

Couldn't we have all the private sector efficiencies that you just talked about by awarding to the lowest responsible bidder the right to manage these funds and administer them, and yet have the public sector savings of the lower cost of acquiring the funds? Wouldn't that address both concerns?

Mr. **Banks**. Well, it is problematic when you take a look at the history; for instance, the Congress passed the National data bank and it's been almost 5 years in development and the vendor hasn't been chosen.

So it is very difficult to put in place complex systems that will—there's been 53 million that have received student loans. So it's an extremely complex and large number of units you're dealing with.

Mr. **Andrews**. I accept that, that there's a fairly sanguine assumption to assume that these things are going to happen the way we want them to. Things apparently rarely do here.

Would anyone else on the panel care to address the questions I just asked?

Mr. **Hough**. Mr. Andrews, may I address the question? One quick comment, and I represent a guaranty agency.

The lenders do earn a very marginal profit on this program. As far as we can tell, they don't earn nearly as much as they do on other consumer loans. I think if the Federal Government were to acquire capital and contract all the activities out, they would pay about the same thing in contracting it out. All the entities that they would contract for would seek a very marginal profit. And I believe you'd probably find the same basic cost of operating the program and possibly even greater, based upon the comments he made.

Mr. **Andrews**. You believe that a spread of 80 to 120 basis points on a borrowing in the magnitude of, what, $12 billion a year is going to be consumed by the difference in administrative costs? That's what you think?

Mr. **Hough**. Yes. I do believe that.

Mr. **Andrews**. Okay. Anyone else? What does Sallie Mae think about this idea?

Mr. **Hough**. We have generally reserved our comments because the proposals that purport to be direct loan program proposals are fairly broad in scope and sparse in details. You're asking questions about the cost component in the area in which there are absolutely the fewest details, and that is how operationally you put this together.

It really is not beyond an estimate to say that a very substantial portion of the 80 to 120 basis points would be put at risk in quickly getting an operational means of making this transition. I wouldn't go so far as to say it would take up the whole 80 to 120, but it would take up enough a big enough piece of it that you then get to the next level of inquiry, which is should the Federal Government be putting out $12 billion and upwards of perhaps 50 or 70 billion dollars of its credit and its capital in this program to save what may be much more like 25 to 30 basis points.

I think the second piece of it is that——

Mr. **Andrews**. Well, how many additional students could receive student loans if we had those 25 to 30 basis points? My quick calculation says if we save a billion dollars, we might be able to open up eligibility for about 200,000 people at the same cost that we're paying now in terms of authorization.

Mr. **Hough**. In the absolute world, if everything came together as nicely as we'd like it to, your numbers would probably be accurate, if not underestimates. But there are far more colleges and universities who would have a stepped up role in this program, as near as I can put it together, than there are today, and the numbers of banks.

A lot of the problems that we have in sorting out student status, student eligibility, as holders and lenders will be passed on down to either the government or, even more likely, to the colleges and universities themselves. On the college and university's shoulder will be the responsibility of tracking student status.

That's a tough problem when they're dealing only with students who have never moved, but there is a great deal of movement between educational institutions. Someone, in tracking that movement, has to be accountable to validate where the student is and where he has been, and to accept the liability for doing that accurately.

Today, the holders have that liability. If the holder makes a mistake, it pays for it; the government has no cost. The program, to be cost neutral in that issue, has to pass that exposure to some party. There won't be a bank holding a loan to accept that cost, so I will conclude that it's either going to be the college or university that bears that financial liability or the contractor.

If the contractor has to take that liability up, I will guaranty you that it will use all that 80 to 120 basis points of margin because it is an undefined liability today, and what I presume would be an undefined liability to the contractor.

Ms. **Dong**. Mr. Andrews, as a student on this panel, can I respond to that?

Mr. **Andrews**. Sure.

Ms. **Dong**. I, of course, understand the concerns of my distinguished colleagues on this panel and, of course, we have our own questions that I've outlined in my written testimony. But all I know, and I know the typical student knows that a billion dollars paid by this Federal Government to banks to insure that there is capital, you know, the difference between the interest rate that we offer students and the market interest rate.

I know it's a billion dollars that doesn't end up in students' pockets. It's a billion dollars that we have to put aside to make sure there's adequate capital. It makes sense if we move to a direct lending program and capital comes straight from the Federal Government to the students' pockets. That's a billion dollars that can go and increase grant aid.

I, of course, recognize there's administrative concerns, transition concerns and who knows exactly the amounts. But we know that that could be a savings.

And I would also say that right now we have 13,000 lenders, 50 guaranty agencies, secondary markets. Students find this an incredibly overwhelming situation. The typical student knows that she has to not only deal with her financial aid office, but has to deal with different lenders, guaranty agencies. It is an incredibly complicated system and we think that this is a proposal that's worth looking at.

We especially encourage to look at American Council on Education's coalition proposal, which I think is very visionary in saying let's make this an optional program for institutions that feel that they can take it on at that time. Because through an optional program and a phase-in, we can then see and better understand your concerns and see how they play out. An optional program, I think, would make most sense.

Mr. **Andrews**. Of course, in fairness to the other members of the panel, there is an empirical issue here, and that is whether or not that billion dollars is actually an efficient number. Because if the costs were transferred over to some other administrative arm, whether it would be higher than a billion dollars or not.

One more question for Mr. Farrell. On page two of your testimony you say the administration is going to propose delayed loan disbursements for 60 days to first year students at schools with default rates over 30 percent.

What is that designed to accomplish?

Mr. **Farrell**. Thank you. That's designed to get at the problem that's developed that dropouts in programs that are of poor quality occur very early. There is a tie between quality and the default rate, although, clearly, program quality and default rate are not the only elements that are involved.

This is an area where I'm talking about cooperation from the system. The schools that participate in this program can have a little give here from the standpoint of that kind of a measure that's designed to strengthen the program overall and can accommodate the student within that framework.

I'd also, if I might, like to comment on your question on direct loans versus the present system.

Mr. **Andrews**. Before you do that, if I could just ask how you would respond to this argument: Couldn't this rule actually increase the default costs of this program in the following way? The proprietors of proprietary schools are going to have a cash flow problem if loan disbursements are delayed for 60 days.

They are going to compensate for that by going to a bank and getting a line of credit, for which they're going to pay, if you can borrow money from banks in America anymore these days. They're going to borrow money from a bank; they're going to pay a substantial interest rate to do that, and they're going to pass along that interest rate in the cost of higher tuition.

So, in fact, what's going to happen is people are going to borrow more money to pay higher tuition to go to these schools. And where the default problem persists, instead of defaulting a $1,500 semester tuition, they're going to default a $1,700 semester tuition.

Isn't this counterproductive?

Mr. **Farrell**. Clearly, you can always look at measures whose goal is to strengthen the program from opposite points of view. When you're looking to take such an elaborate system such as we have and tone it up, a lot of your proposals are going to be elaborate. Some of them will be large; some of them will be smaller.

To fix the kind of system that we have right now requires the cooperation of all of the organizations that have done well under it. And the proprietary schools have certainly done well under it, as have the banks, the 4 year universities.

I prefer to look at the problem as a family problem. The Department of Education has got to take the leadership role and then to get the kind of improvement that we want now while we look at other alternatives, we've got to have some give and we've got to have some cooperation from all of the organizations that participate.

Mr. **Andrews**. I'll close just with this comment. I assume this is not the case, but this looks suspiciously like another OBRA cash management game that claims to be deficit reduction. I've gotten hundreds of phone calls and letters from doctors in my district who are upset that Medicare reimbursement has been delayed for some arbitrary period of time.

And it's part of the so-called deficit reduction measures that were passed around here last year. In fact, all this is is that the government is holding onto its money longer, making more interest on it and, in effect, passing this cost off to the patients.

I hope that we're not doing the same thing here by passing a cost along to students at proprietary schools. I assume that's not the intention.

Mr. **Farrell**. The goal of that measure is exactly what our proposals say, and that is to get at one of the elements of high default rates.

Mr. **Andrews**. Thank you very much. Thank you, Mr. Chairman.

Chairman **Ford**. Mr. Sawyer.

Mr. **Sawyer**. Mr. Chairman, let me just then thank my colleague, Mr. Andrews, for a very productive line of questioning and the thoughtful answers that we received from the members of the panel.

Let me also thank Mr. Banks and Ms. Dong for their thoughtful comments about the importance of counseling early on in this entire process. I very much appreciate that.

Let me touch on a point that Ms. Dong raised, and it really gets back to the question of flexibility with regard to the circumstance that she described on page eight with regard to the fraudulent defaulters in Florida.

And let me ask you, Mr. Farrell, if you could comment on that and, perhaps, put the department's position on that in a more understandable light.

Mr. **Farrell**. Fraud, of course, has to be proven in court. One of the things that struck me when I arrived and started evaluating our programs was the lack of contact that we seem to have with students who are ultimately the purpose of this entire program, not for any of us here.

And we clearly will involve the ideas and the input of students much more in our evaluation of schools in the future.

I can cite a personal instance that's come to my attention in the last couple of weeks. A member of the Congress wrote a letter to the Secretary, attaching a letter from a constituent who related the story of her son who had attended a school which he dropped out of after about 8½ weeks.

He didn't receive at all what he had been led to expect. He was given an element of the program that was referred to as an externship where he got an interview at a company that had been advertising—he'd seen their ads before he went to the program—had been advertising for months, that basically, everybody's welcome. And it was clearly providing a wage that wasn't going to make it possible to pay for the loan that was involved in this.

Now, what are we doing about that? Monday our program reviewers will arrive at the school to begin a program review. And that's what I mean that the insight that you get from students, the consumer in this case, is very valuable and helps you cut through some of the other stories that are presented as explanations for, for example, high default rates.

High default rates are not a simple issue; they're very tough to get at. They clearly are not just the result of fraud and abuse. They're the result of a whole host of problems.

But we can probably do the best job that we can in evaluating what a particular program is about by knowing what the students have to say about the quality of the education that they've been provided with.

So we're working on that, and we're going to press ahead full steam with a variety of ways that we can get far more input from the students into this whole arrangement.

Mr. Sawyer. Well, I can appreciate that the circumstances that was described in the testimony that we heard this morning was very difficult to respond to. And I fully understand everything that you said about the topics that you did respond to.

But I just have a very difficult time understanding how those in whose names these loans apparently were taken out and who had no idea that loans were taken out in their names could be held responsible for the debt that resulted.

And any comment that you could give me at a subsequent time would be appreciated.

Mr. Farrell. I assure you that I will look very carefully at that, also.

Mr. Sawyer. Thank you very much.

Chairman Ford. Mrs. Unsoeld.

Mrs. Unsoeld. Thank you, Mr. Chairman. In the Secretary's statement he said that, "A fundamental premise of our GSL proposals is that States should take an active role in establishing strict licensing standards for postsecondary programs and to better monitor and regulate the activities of a guaranty agency.

"To this end we propose that the Secretary set minimum licensing standards and regulations, and each State would back its designated guaranty agency with the equivalent of the full faith and credit of the State. We would also require States where school default rates exceed 20 percent to pay a share of the default costs."

We could probably go round and round on the philosophical issue. But, Mr. Donovan, in addition to or other than the philosophical, are there some peculiarities to the State of Washington that may also affect other States that you might like to comment on this particular proposal?

Mr. Donovan. Well, there certainly are in the State of Washington. I can not speak for many of the other States, but the State of Washington does have a provision in its State constitution prohibiting the State to lend its credit. In addition, it has a prohibition to support any religiously affiliated institution.

A number of cases have been taken to our Supreme Court and they have ruled that any such attempts are totally unconstitutional. We did attempt to create a State secondary market in the State of Washington and it was ruled unconstitutional by a unanimous ruling of our State Supreme Court.

I'm certain that if the State were asked to back the guaranteed student loan program in any way, it would in turn be found unconstitutional. And the State of Washington could not participate in the Federal program.

Mrs. UNSOELD. Thank you. Mr. Farrell, do you want to comment on that?

Mr. FARRELL. Well, I think the individual circumstances of each of the States clearly would be taken into account when we're working into a new element of the program that way. And I'm sure that accommodations can be found to reflect the diversity, the important diversity, that's represented by the States.

Mrs. UNSOELD. I know there have been several attempts at constitutional amendments, which have been resoundingly defeated. So it's a peculiarity of at least our State, and I doubt that it is alone.

Does anyone else want to comment on that particular aspect?

Ms. DONG. Congresswoman Unsoeld, I would just like to caution, and I know that everyone understands, that whatever we talked about, you know, increasing participation of other agents involved in this whole process that we be very careful not to pass those costs along to students. Because actually Congressman Coleman was very insightful and mentioned that when you talk about risk-sharing, let's say by passing on more costs to State guaranty agencies, that could easily, then, be passed on to students in the form of higher origination fees, which clearly, as we've indicated, would not be in the interest of students being able to pay for their college education.

So we look forward to working with this committee to insure that we look carefully at every step we take and who it really is passed off to.

Mrs. UNSOELD. I appreciate your comments. Thank you, Mr. Chairman.

Chairman FORD. Mr. Reed.

Mr. REED. Thank you, Mr. Chairman. I'd like to follow up on the comment made by the gentlewoman from Washington. The State of Rhode Island constitution forbids the pledge of the full faith and credit of the State for any amount beyond $50,000 without a referendum of the people. I would suspect that that's probably the rule in most jurisdictions, where there are limits on the State pledging its full faith and credit.

So you're going to find 50 different sets of restrictions and all of them, I would suggest, will include some significant limitation on pledging the full faith and credit for this type of program, Mr. Secretary. So I think you should begin right now to look at that.

I have some specific questions with respect to the banks' participation in the program, and perhaps Mr. Banks or Mr. Grigley could answer this.

Essentially, how do the banks earn their money in this program; for instance, interest rate spread, would they receive the difference between the cost of funds and what the students are paying? Then there are origination fees, insurance premiums and special allowances rates. Could you explain, specifically, the source of income for banking institutions in this program?

Mr. Banks. Okay. There's actually, to simplify it, two things. A bank has a contract with the Federal Government for subsidy and he has a contract with a State agency for guaranty. All fees are paid either to the State agency or to the Federal Government. Lenders make their money in the program through the yield of the loan, which is a combination of the borrower's payments plus the interest subsidy from the Federal Government. Offset by that is the cost of funds, the cost of the bank raising those funds, and the differential, the subtraction, is then servicing cost, of which, you know, to service an in-school loan may be $2 a month, to service a collection loan is $13 a month, somewhere in that range.

So you, basically, have the revenues from the Federal Government and student in repayment, the cost of the funds that the bank pays for it, offset by servicing expense.

Mr. Reed. So when we're talking now about possible savings through the application of a direct lending program, essentially, what we would be saving at the Federal level is the subsidized interest payments to banks? Is that the biggest savings?

Mr. Banks. That's correct. The difference between that and the cost the Fed raised the funds at.

Mr. Reed. And that would be an immediate savings that could be realized?

Mr. Banks. But, again, it's going to be offset by all the servicing costs.

Mr. Reed. What about the special allowance rates? Are those paid to banks?

Mr. Banks. Correct. For instance, during the in-school period, the bank receives from the Federal Government T-bill plus three and a quarter. It's basically under the contract between the bank and the Federal Government. In repayment the borrower, for instance, would pay the bank 8 percent and the differential would come from the Federal Government.

Mr. Reed. So when we talk about special allowance rates, we're really talking about the interest subsidy?

Mr. Banks. Correct.

Mr. Reed. I'm trying to understand.

Mr. Hough. You have to make a distinction between the interest benefit and the special allowance. Interest benefit is payable in-school or during deferment periods and runs to as much as 8 percent; special allowance is paid above the 8 percent rate at the time T-bill plus three and a quarter exceeds 8.

Today, with a Treasury bill of five and a half, three and a quarter on top of that, brings the rate to 8.75. The lender receives 8.75, 75 basis points from the special allowance, 8 percent from the student or from an in-school interest benefit.

The last 6 years of the loan's repayment, under current law, there is no special allowance at today's rates because the rate to the student is 10 percent.

Mr. Reed. So the special allowance rates is an attempt to control for interest fluctuation in the market?

Mr. **Hough**. Yes, sir.

Mr. **Reed**. Okay. And the administration's proposal in terms of default rates is that they would essentially reduce the special allowance of those institutions that have high default rates?

Mr. **Farrell**. Yes, and I should point out to the committee that that is a measure that strikes at and focuses on a relatively small number of banks. I think the number is about 155. It is, I would say, one of those elements of our recommendations that are important, small tone-setters and measures to get at the whole system. So it isn't something that's going to have a sweeping impact on a large number of institutions.

Mr. **Reed**. I am searching for the proper analogy, but is this something like a slap on the wrist, perhaps, or an attention getting technique and not a fundamental attempt to reform the system?

Mr. **Farrell**. Probably not even a slap.

Mr. **Reed**. Well, thank you for putting it in perspective.

The next question I have, and I guess you've already answered it, Mr. Farrell, is that you don't really anticipate any sort of instrumental effect of this thing as a major way of controlling or changing bank behavior and being more attentive to default rates. This is more of a gesture or a genuflection to reform, not really a significant attempt to change behavior?

Mr. **Farrell**. No. I wouldn't want to leave that impression, sir. I think if you look at all of the measures taken as a whole, the sum total effect is to require all participants in the program to contribute to a tightening up of the standards. I didn't mean to downplay in importance that particular item as part of the entire package.

Clearly, one of the ways that you help keep a program from developing further problems is that you look ahead a little and you establish some parameters that will help, perhaps, direct things in the channels that you'd like to have them. So I'd put it more in that perspective rather than trying to correct a major problem.

Chairman **Ford**. Will the gentleman yield to me at that point?

Mr. **Reed**. Certainly, Mr. Chairman.

Chairman **Ford**. I'm glad to see him pursuing this. And, Mr. Farrell, I have to keep telling you I'm not trying to pick on you. We've discussed this before in the committee, and we've discussed it with the Secretary.

On the 31st of May I sent a letter to the Secretary informing him that I was enclosing a copy of a Congressional Research Service memo showing what we had done since the last reauthorization—well, actually since 1980—to tighten up, as we described it when we were doing it, the guaranteed student loan program.

This memo has 14 separate laws signed by successive presidents containing 80 major provisions, each one of them designed to do something to tighten up or tune up the guaranteed student loan program.

And what I asked the Secretary to do, and this shouldn't come as a surprise to you, is what I'm going to ask him in every hearing we have, again, "How much can you tell me, Mr. Secretary, have you done about implementing these changes in the law and why haven't you done anything about the others?"

Now, Mr. Banks mentioned one in particular that we've talked about—the student loan data bank, which the Library of Congress identified as an important tool to improve Federal debt collection and improve debt collection practices.

Now, today, the administration comes in through you and on page three of your testimony wants some more provisions in law, including such things as the right to require a driver's license number of a borrower, other borrower locator information and a really extraordinary one, authorizing guaranty agencies and the Secretary to garnish a defaulter's wages. They can do that now.

So unless you want to give the agency itself, the department, the power now exercised by the court in issuing a writ of garnishment, you aren't really suggesting anything different. And I might suggest to you that the reason that that's a tough one is that the State of Texas won't let you garnish wages for anything, and most other States will let you garnish wages depending on family size, amount of income, regularity of income, nature of the debt and so on. And it's a real maze out there that a lot of people have looked at.

But let me take you back to where we would be now if your predecessors had done something about the changes we made in the law. And I want this to be repeated over and over to the department because I'm not going to waste a lot more time tightening in this reauthorization when I find that the big tightenings that we did in the last reauthorization are still sitting on the shelf with nothing happening.

Now, this data system was authorized in 1986 and it was pretty general in our authority to the department. But then we said the information and data system, "shall include, but is not limited to." And if we had such a data system, you could tack on the driver's license right now.

"The amount and type of each such loan made" Now, doesn't that sound like a terribly burdensome thing to do is keep track of the amount and type of each loan made? "The names and social security numbers of the borrowers, the guaranty agency responsible for the guaranty of the loan, the institutions of higher education or organization responsible for loans made under Part E, the eligible institution in which the student was enrolled or accepted for enrollment at the time the loan was made and any additional institutions attended by the borrower," something that Mr. Hough made reference to.

And it goes on and on an on with one thing after another that we thought, as a minimum, ought to be in such a data bank. Now, last week the GAO testified that in their opinion, the department would have the data bank ready to operate in late 1993. That's 9 years from point of start.

Mr. Banks apparently knows something about it because he said that there's no vendor yet selected to establish the data bank.

I don't want you to be responsible for answering for this, but what I expect to get back from this inquiry to the Secretary is that while looking at all these other things is to tell us what happened. You're suggesting a 60 day delay in disbursement.

We did more than that: We put a 30 day delay in, but we also provided for multiple disbursements, which is a way to avoid disbursing money on a loan after the kid had left in the first semester and we were still disbursing. We didn't have to go look for the money back. If he wasn't there for the second semester, he doesn't get the second half of the loan.

That's been there for a while and yet because we don't have this kind of a data bank, we can't fairly ask you to tell us whether it's working. We know it's causing a lot of inconvenience, but we don't know how much we're getting out of it.

Until things like these changes are actually put in place, we're not going to be able to do it. Whoever is going to be doing this reauthorization 5 years from now isn't going to know any more than I knew in 1980 when we started asking for these things or any more than I knew in 1985 when we asked for them again.

And we've passed 14 laws with 80 specific provisions just on tightening up guaranteed student loans. Everybody that's come before us has a suggestion for another law. It's like passing more traffic laws and not hiring any traffic cops or hiring traffic cops that don't want to enforce the law.

So we're going to continue asking the department not to explain why it wasn't done, but tell us when can you get this done. Could you do better than the end of 1993, for example, on this data bank if you really decided that it was important? And could some of the other things that haven't yet been implemented be put on the list to go now?

I have no question about the willingness of you and the Secretary to move, but we want to be able to show the education community, as well as the students themselves, before we go to the floor with this bill that we're not doing more things to them while still doing nothing about the things we tried to do to them before.

It bothers me that some of the bad conduct that was going on out there at the beginning of the last decade is still there at the beginning of this decade and people think that this committee and I have been sitting here like dummies letting it go on.

I want you folks to step up and take your best cut at the ball. And if we need more legislation, we'll give it to you. But we're not going to give you more legislation until you start using what we've already put over there in the department.

I yield back to the gentleman from Rhode Island.

Mr. Reed. Thank you, Mr. Chairman, but I have no further questions.

Mr. Grigley. I wanted to make a comment to Mr. Reed. I'm Mr. Grigley. You addressed a question earlier to me about defaults.

It should be pointed out that banks do not control default rates, that we comply with the regulations as required. And if we do not, the loan claim is rejected and the bank absorbs the loss.

It would be interesting to note how much of that has gone on in the past. Thank you.

Mr. Reed. You've reawakened my questioning instincts. Just to follow up, essentially these loans are guaranteed by someone other than the bank; is that correct?

Mr. Grigley. That's correct. They're guaranteed by the guaranty agency.

Mr. Reed. So when a loan goes into default, the guaranty agency will relieve the bank of any loss; is that correct?

Mr. Grigley. Provided that the lender complies with the due diligence requirements in the collection of that individual loan.

Mr. Reed. But assuming that the due diligence is done, and I think that banks like yours and Chemical do it quite routinely and quite thoroughly, that the bank ultimately does not absorb any losses in these things or in a very small number of cases, and it's through your own lack of due diligence?

Mr. Grigley. That may be correct. As in my testimony, I mentioned that there are differences between guaranty agencies and standardization is needed desperately for banks that operate in multiple States.

Mr. Reed. Thank you, sir. Mr. Chairman, thank you.

Chairman Ford. Mr. Reed, it's only fair, however, to note that you were right on it and he dodged it a little bit. If due diligence isn't exercised, you can't blame anybody but the lender because the only due diligence requirements that affect your guaranty are the due diligence requirements that are given specifically to the lender.

The due diligence requirement doesn't require you to collect a damn dime, does it? It only requires that you send a letter and that you try to collect. It doesn't require that you succeed.

So there is no intervening factor like a reluctant payer or anything else that affects your insurance other than the failure of your own employees to do the specific steps that are required of them to exercise due diligence. They don't have to go out and grab somebody and beat them over the head to get the money; they simply have to send them a letter on time and keep their files up. Isn't that correct?

Mr. Grigley. Yes, that's partially correct.

Chairman Ford. I'll be glad to pursue your question. What part isn't correct?

Mr. Grigley. There are different regulations and rules that we lenders abide by when submitting claims to guaranty agencies that where in some cases they ask for original checks and for others they ask for copies. And claims get denied for little errors such as they, as we indicated in our testimony.

So we should clearly review what the intent and what the actual effort is on the part of the lenders. And I believe that most of America's banks do make a good faith effort in collecting student loans.

Mr. Reed. Will the gentleman yield? Just a comment, perhaps, more than a question, is that this is an interesting sort of due diligence. Most of the time banks do due diligence before they give the money away; in this situation, they do due diligence when they try to get it back. I mean, I don't want to be too flip about this, but one of the missing ingredients, perhaps, in the program is that banks really don't do—or at least let me raise the question: How much due diligence prior to the extension of the loan is done on the credit worthiness of a borrower? Isn't it rather automatic given the——

Mr. Grigley. That's correct. First of all, there's very little due diligence done up front because of the regulations. Furthermore, there is probably no credit history on 99 percent of students, first time borrowers anyway. In addition to that, the number one criteria for granting any loans in the banking business is the ability to repay, credit history second, and collateral third.

And based on the fact that no one has an ability or a proven ability to repay those loans, certainly there is a lot more risk in that than there is in other types of consumer loans.

Mr. **Reed**. Thank you, Mr. Chairman. Thank you.

Chairman **Ford**. I think in fairness to the banker, I should observe for the record that we don't permit you to find out whether the person is credit worthy before you make the loan. Because if everybody who got a loan was credit worthy, you wouldn't need this program.

Mr. **Grigley**. I agree.

Chairman **Ford**. So it's not your fault that you're lending money to people who aren't going to have the ability to pay. Thank you very much.

Mrs. Lowey.

Mrs. **Lowey**. Thank you, Mr. Chairman. I'm going to delve into another whole area that has been discussed briefly this morning and has been discussed several times in meetings in my own district with loan offices.

What I'm interested in is helping the students who really want to repay their loans repay them. And I'm interested in your comments on several proposals that have been put on the table in these hearings and in my district. And I'm interested in the impact on the students, whether it really will help them repay the loans. And I'm also interested in the cost that these proposals would present.

These are the proposals: One, extending the grace period. It's now 6 months. There are those who have come to me and said, "Well, if you extended to nine or extended it to ten, it would really help the students repay the loans."

Extension of the repayment schedule: Most call for extending it to 15 years; some people have come to me and said it should even be extended further. And, incidentally, in regard to that, and perhaps, Joe Case, you can also elaborate on your comment when you said, "Finally, we're aware of no evidence or studies that indicate such deferments change the actual academic choices or career objectives of students."

Some students have come to me and said, you know, "How can I go into teaching? I can't afford to go into teaching. I have to begin repaying my loan in 6 months." So perhaps someone could address that, too.

Another proposal is changing the manner in which the loans are repaid so that student payments are smaller in the early years and larger in the later years when students are more likely to have a decent income.

And, of course, I'd like you to present to us any other proposals you have in this regard. So I would appreciate your comment on these proposals, which have been the ones presented to me most often, or any other proposals, in addition to getting the data bank in place so we know where these students are. I think that certainly was presented the other day.

Anybody care to begin?

Mr. **Case**. As for extension of grace periods, this was, in fact, a provision in the statute until revision—I don't remember now.

Chairman **Ford**. We're checking to see if we did it in 1986 or in the first reconciliation.

Mr. **Case**. 1986, I think it was. There are positive things and there are negative things about it. The negative is that it does cost the government more to continue full subsidization of the subsidy for that extra 3 months.

Mrs. **Lowey**. Excuse me for a minute, and I would appreciate your comment. We have to compare that cost to the cost of a loan default, and not getting any money at all.

Mr. **Case**. True, absolutely. On the other hand, our student who may stop out for a semester and enter repayment because of the 6 months grace period in those days did not have that occur. They resumed—the grace period did not expire and, therefore, was, in essence, erased once they were back in student status.

And so there is that positive side to it, but obviously there would be costs to be taken into consideration on both sides as default versus the subsidization.

Mrs. **Lowey**. Have you looked at that? Do you have any comparison data? Perhaps Mr. Farrell would.

Mr. **Case**. I'm not aware of any.

Mrs. **Lowey**. Well, why don't you finish and perhaps we can hear from Mr. Farrell.

Mr. **Case**. As for extension of repayment period, that indeed is a recommendation of NASFAA's, in connection with expansion of borrowing limits. A 10 year repayment period and the provision for consolidation for larger loans which can extend the repayment period currently under statute given present limits, I think, is probably adequate.

If we do extend the borrowing capacity of students, I believe there should be an extension of the period for repayment.

As for effects on choices, we are aware of no studies. In fact, the only study that I'm aware of would indicate that borrowing, admittedly, of college students and not others did not have an effect on their pursuit of a graduate study; rather, their prospective incomes was the greatest influence on what choice they chose for pursuing study beyond the baccalaureate degree.

Mrs. **Lowey**. Mr. Farrell.

Mr. **Farrell**. One of our proposals is to require lenders to provide a graduated repayment schedule, which would repay only interest in the first year of repayment and then require the borrower to resume repayment of principle after the fourth year, keeping it on the 10 year statutory maximum repayment schedule. The thought is that that would establish a discipline for the repayment.

I'd like to comment, if I may, you made reference to the chairman's observations on the data system. I couldn't agree more that one of the major programs that we've got to put a maximum effort behind is that one. The little fixes are sort of to take care of things for now. Clearly, one of the shortcomings of the program is the inability to know some of the things that we'd like to know and you'd like to know.

And we're going to put a major effort behind that and we'll give you a report.

Mrs. **Lowey**. I personally would like to thank you. I haven't been at this as long as the chairman, but certainly at the other hearings it was just unbelievable to me that we don't have this data bank. And witness after witness just talked about incompetence at your department, and I'd like to feel confident that we can look forward to this data bank in the near future.

Mr. **Farrell**. Thank you.

Mrs. **Lowey**. Selena.

Ms. **Dong**. We are very much supportive of the first two proposals that you mentioned—restoring the grace period back to 9 months and extending the repayment schedule to 15 years.

We agree with you that many students genuinely want to pay back these loans and by making it difficult to repay, then we end up with the larger cost of defaults. In particular, the grace period: sometimes after graduation it's difficult to find a job within 6 months, especially in these times of economic difficulty. And you've seen the stories about, you know, graduates having real tough times finding jobs in their fields.

And so if we extend it, sure, we have to pay the cost of the additional 3 months of the grace period, but we ultimately allow them to pay off the loan. It's in our interest as well of that of the student.

And extending the repayment schedule 15 years would also help in the long run because students want to pay back their loans. You know, time and time again, I think we need to stop seeing defaulters as deadbeats who refuse to pay their loans; a lot of them would like to but simply can't.

And as you know, once you go into default status, you can not reverse that unless you pay the whole loan off. And many times, that just is simply not possible. And so we want to work with you and this committee to make the repayment possible.

And last, I just want to make a comment about the deferment options and how, perhaps, we don't have evidence showing that having deferments and partial cancellations for students going into teaching will necessarily encourage them to do that.

We think that's, once again, a result of inadequate publicity on the student aid program, which is why we endorse the idea of a publicity campaign as found in Congressman Sawyer's Student Counseling Assistance Network Act because, again, students just don't know. And if they don't know, they can't plan ahead to say, "Well, sure I have this big loan but I do pursue my dream of being a teacher, it will be partially cancelled."

So we think a publicity campaign would help us target those students who want to go into low paying professions but would, again, with your assistance in getting adequate grant aid, especially a Pell grant entitlement, all students can graduate and make post-graduation career job choices based on their desires and their goals and not on economics. So everyone can go into a job regardless of its pay.

Mrs. **Lowey**. I appreciate that because I firmly believe, in my contact with the schools in my district and the loan offices, they felt that a majority of the students really do want to pay back. And either they get lost out there or they just can't pay because of real life circumstances. I appreciate that.

Mr. **Donovan**. May I add a few comment to this? NCHELP has a proposal in its reauthorization paper to pilot test an extension of the 120 day delinquency period that constitutes a default. We found that there are enough instances of rehabilitation, in other words, selling the loan back to the lender because it was purchased in default but the student wishes to repay.

There are enough instances of that that we'd like to at least pilot test an extension of that. So you might consider that.

But secondly, I would add, too——

Mrs. LOWEY. Excuse me. Was that in your testimony?

Mr. DONOVAN. No, it's not in my verbal testimony. Actually, it was not in my written testimony either, but I can furnish you copies of the proposal itself.

Mrs. LOWEY. Thank you.

Mr. DONOVAN. I would like to add also, without addressing specifically your other items, but should mention that over the years a number of adjustments have been made in law which we have found to be of a good deal of benefit to students, such as the unemployment deferment, which is used very extensively. We have found it is used very extensively and effectively, too.

We've found the loan consolidation provisions are used quite effectively, and others may wish to comment on that. We also find that our lenders use a good deal of forbearance options to, for instance, require that the student pay interest only for a certain period of time or capitalize for a certain period of time and this sort of thing to ease them through harder periods.

So I would state that a number of things have been done. But let me state also one last comment that as a guarantor, we have found that without addressing the manageability of debt, which deals with delinquencies and so on, just talking about the amount of default, where are defaults coming from, can any of these ease the default issue, we have found that 70 percent of our default payments are for dropouts, for individuals who have dropped out of school.

I think the dropout issue is by far the biggest issue, if one were to try and curb defaults. We have found also, and I can't cite figures but I'm sure that others could, that defaults are very heavily correlated to the very early periods of studies, freshman, some sophomores. Once you get to upper division, the dropout rate is much lower.

I believe that, and we've talked about it earlier, that if we could target grants more heavily toward that very early period of time and avoid the loans, we're going to avoid a lot of the defaults resulting from the dropout phenomenon.

Mrs. LOWEY. Thank you.

Mr. HOUGH. At the risk of opposing, in this instance, a benefit to students, which we don't like to do, I would like to emphasize a couple issues related to the first issue, which is extension of the grace period from 6 to 9 months.

There are in place today in the law and in the regulations from the department a number of ways to handle students who are hardshipped and need that extra time. Mr. Donovan mentioned the unemployment forbearance; there are other means of forbearance and deferments and these are used.

I think the incidence of default because a borrower needed those extra 3 months and didn't get relief from forbearance and deferment are very small.

So you've got, at the chairman pointed out, a lot of strength in the program today if we can get the word out and use it effectively.

Mrs. LOWEY. Just let me stop you at that point. So the question is: Are the students getting the appropriate counseling? Are they aware of that? And Selena's saying no.

Mr. HOUGH. Well, we have real life experience of dealing with several million borrowers and we get audited and we get reviewed and we have claims that are examined by guarantors in every State of the country, nearly.

This is not a problem where we are instructed that we are being short with those benefits in any respect. The benefits are there; they are extended, I think, with great regularity. There is a real danger in aiming that particular grace period modification where, in fact, I think a much more troublesome problem is the lack of a grace period with all the loans that are made under the SLS program.

And that is in numbers a far larger problem, where you have graduate students and independent students who have to use both the SLS and the Stafford program and then have to sort through the complexity of a lender who under the law is obligated to come after them right away for payments on the SLS loan while the Stafford loan is going through a period of deferment or grace period.

We need a grace period for the SLS program if we can figure out how to pay for it. As far as the student default and the deferment issues are concerned and repayment risk, banks have dedicated consumer credit counseling services within their operations these days. And I know in my bank I have a dedicated consumer credit counseling service in addition to a bankruptcy unit.

And we will work with any customer to refinance their debt, extend it do whatever it takes to keep that customer with us and also avoid filing a claim or end up with a loan loss any way possible. This is going on across the country today. Consumer credit counseling services are working with banks, and they're a nonprofit organization. And we can also include them in student lending in the future.

Mrs. LOWEY. I appreciate your comments, but to pursue that for a moment, at the last hearing there were a range of problems, it seems, presented to us as a result of the lack of a data bank. So you're saying that the bank which would have a good record of those to whom they've lent money before that person goes in default would call them in, present them with all the options? Then why do we have such a problem? They don't come in? You don't call them? They disappear.

Mr. GRIGLEY. That's correct. The problem has gotten worse over the last few years with the economy. And we have felt that, probably, too late that we should have communicated more with customers early on during the default period.

Mrs. LOWEY. Thank you very much. And the hour is late and I know Chairman Ford wants to conclude. I just have one more quick question, and if someone could respond to me.

I'm very interested, and I know the chairman is, in the whole issue of how do you help those in the middle class. How do you help them get the aid? And I'd be interested in someone's response to this. Should we expand eligibility for Stafford loans by changing the needs analysis or by another means, or enact a separate middle income loan program, or look to some other means entirely? If someone could just respond to that. How do you deal best with that middle income student that's being squeezed?

Mr. CASE. In my view, the greatest access was provided from 1978 to 1981 under the previous Middle Income Student Assistance Act; on the other hand, there were a good many students at my own institution. The borrowing rate increased to approximately two-thirds of the student body. It is currently at about 44 percent of the student body.

So there was an additional 20 percent or so who were borrowing without current definition of need. Perhaps the interim period from 1981 through 1986, where we had a very simple need test that focused on income, ignored assets, asked basically for four data elements, would be the course that, at least personally, I would say might be the middle ground and the course to go.

Mrs. LOWEY. Thank you. Yes, Mr. Farrell.

Mr. FARRELL. Thank you. I would comment that we can always review adjustments in formula that involve things such as home equity, farm equity and income. I would just observe that in a time of budget discipline what we're proposing in grants and loans is a very significant increase over the past year and a real effort, I think, on the part of the Secretary and the administration to put as much money as is available into this very important area of student access to education.

Mrs. LOWEY. Thank you very much. I appreciate hearing your testimony, and I look forward to working with you. Thank you, Mr. Chairman.

Chairman FORD. Before you leave, maybe, Mr. Hough and anybody else, in 1986 we extended loan consolidation privileges on the theory that people with a multiple package of loans and, therefore, a large loan burden would be able to negotiate, first, with Sallie Mae and with State guaranty agencies, then with any lender that was willing to play.

As I recall it, you can go up to 20 years with a renegotiated package like that. Is that right?

Mr. HOUGH. Yes. It can go up to 20 years.

Chairman FORD. And does anybody do it?

Mr. HOUGH. Yes. Sallie Mae is consolidating around, in round numbers, 450 to 500 million dollars of outstanding loan debt each year and have been going at that pace since the law was written.

I believe there is an aggregate, perhaps, another 50 percent of that number distributed through all other people offering consolidation. Those numbers are very rough outside of our own experience.

And the range of years selected by the students in our own program run from 12 to 20, and they're fairly evenly distributed. So students exercise judgment when doing the refinancing and tend to balance the higher interest costs with the need to have lower monthly payments.

Chairman **Ford**. Selena, do you think that from the student's perspective it's generally known that the privilege of loan consolidation exists?

Ms. **Dong**. Again, that's another example of where students just don't know these options and would benefit from knowing about them. And I would say that's the same for forbearance options, you know. I think that many of those students who that additional 3 months in the grace period could make a difference to don't know exactly the process by which they can get forbearance on their loans.

But, yes, consolidation is another example of that.

Chairman **Ford**. Well, now, I want you to consider this: The administration is offering a little bit of relief by letting you capitalize the first year of the loan and just pay the earned interest during that first year. That gives you a little stretch out of when to pay back, but that doesn't cost any money. And we thank them for that approach and appreciate their dexterity in avoiding putting any money up.

But if you fool around with that 3 months, I remember when we made the change from 9 to 6 months, and that cost money. And it has to come from someplace out of the program. I've been going through some of the thoughts that you expressed here. Did we make a mistake? Did we discourage people from coming back into repayment because we set the repayment date too early? And did that, in turn, put them into a habit and they're not paying the loan?

The answer that comes back from the people that manage these programs is that if people would come into the bank we would tell them that they've got options other than going into repayment at the end of 6 months if the reason they're looking for such an option is that they don't have a job or they're having a baby or something else is happening.

These things don't come together any place. Where do you think that the obligation of the lending and guaranteeing and secondary market community comes in to preadvise students or borrowers of the options that they're going to have?

In other words, if you could convince everybody to come to your bank, you would sort out automatically some presupposed percentage of what's called defaults in your bank by having them not go into default by exercising one of these options. How do we make it worthwhile for a banker to actively seek to get that information to the borrower?

Mr. **Banks**. Mr. Chairman, I would like to suggest that the Congress, really, has already enacted legislation on this and part of the whole exit counseling process of which we provided two copies of two different videos used in colleges as part of exit counseling, which every graduate has to sign or students entering the repayment phase where, in fact, most of their rights and benefits are advised in this.

It can be a little dry if it was done on a one on one counseling, but a lot of these videos have become very, very good on a upbeat way of keeping them interested while they're being counseled that they are required to sign. And, in fact, it notifies them of all their benefits, whether it's forbearance, deferment, loans consolidation. And, in fact, the Congress has enacted it.

Chairman **Ford**. We've got a lot of language that talks about this kind of intervention. Maybe we're intervening at the wrong point. We've only fairly recently learned that if you want to stop high school dropouts you have to start in kindergarten. That took us 200 and some years to figure that out.

It's pretty clear to us that students do not become informed in spite of videotapes and so on. And it runs through my mind that showing a kid a videotape or giving him a lecture when they're entering college or another school, anxious to do whatever you tell me I have to do. "I'll do it and sign my name because I want this money because I want to go to school."

Now, they're going to remember that about as long as they remember everything they promised a girl on a first date before she agreed to go out with him a second time. I mean, there's a natural human phenomenon that we ought to be looking at here. There is some state, through this whole process, at which somebody ought to be grabbing these people by the scruff of the neck and saying, "Now, you're going to be a person going into payment pretty soon. And you've got to get a job, of course, but if you can't, do you realize that preferable to ruining your credit rating for the rest of your life are these options?"

And where would you do that sort of thing? That's a very direct kind of counseling, Mr. Murphy. I'm familiar with the NATTS regulations that the schools will tell people that these are loans and not grants. And that's very laudable, but I strongly suspect that it comes at the wrong time. It comes at the beginning of the process and not after they've settled into reality.

Mr. **Murphy**. I think there can be things the institutions can do to help. If we were to require lenders, guaranty agencies to maintain dialogue with the institutions after graduation or withdrawal, in terms of identifying and contacting students, I think that would help quite a bit if it was a requirement that those two sectors maintain dialogue with the institutions.

I think another thought, one thing we've proposed is development of creative and incentive programs to work with employers to help students or make direct loan repayments as part of a compensation plan in hiring students or graduates.

I think those two things might help the process after they are thinking about the fact that they may not be able to make the payments or there's evidence to indicate that they're going into delinquency—communication with the institutions and possibly incentives for employers.

Chairman **Ford**. Anyone else have anything else to contribute?

Mr. **Donovan**. Mr. Chairman, I might add that a number of the guarantors, of course, are concerned about this same issue. And several of us have tried various approaches to try to get the word out in a timely manner.

A couple of examples. Some of the guarantors send a mailer to all students who have anticipated graduation dates coming up within the next, whatever, several months stating their various options and some of the deferment and forbearance and so forth.

Others also have developed very easy to present and read little brochures that are handed or sent out to students as they graduate or during the grace period. When we catch up with the student after they leave school we often send materials to acquaint them with these options.

Some of our lenders in the State of Washington use these little documents in their initial mailers to students stating that they're going to be entering repayment in such a period of time. So there are several things that we are attempting to—NCHELP is attempting to compile all these various approaches. And, possibly, we might be able to give you a feel for what really works and what doesn't.

Chairman Ford. Well, how do you react to his suggestion of a requirement that the lender or the secondary market maintain contact with the school after the student leaves, either by graduation or withdrawal?

Mr. Donovan. I'm sorry. Are you asking me that, Mr. Chairman? What do I feel about the lender or the secondary market maintaining?

Chairman Ford. It's been suggested that there ought to be a requirement that the people involved in the process once the loan is ready to go into repayment be required to maintain some kind of contact with the school, inform them of what's going on, use their resources, if you will, to find the student if he can't be found.

Mr. Donovan. I am very—we do that and I believe it should be required that guarantors and lenders stay in contact with schools if there is any indication of, you know, inability to contact the student or confusion in correspondence and so forth.

Chairman Ford. Wouldn't you think that the requirement ought to go the other way? That the school ought to be required to provide whatever it knows about the borrower to the secondary market?

Mr. Donovan. Absolutely. Yes, I do.

Mr. Hough. Mr. Chairman, to go back and talk about our favorite subject today, the database, that's what the data base is there for. Students, schools, guaranty agencies, secondary markets, lenders, the Federal Government, we all know what the status of record was if the data base was there, was maintained and was relied upon.

It sounds extraordinarily simple in that subject of status, and it is simple. We just have to get it in place.

Chairman Ford. It becomes very complex when you talk to a student who goes to undergraduate school in one State and deal with one State's set of lenders and guaranty agencies and then goes to graduate school or professional school in another part of the country. They deal with a whole new set of faces and then start getting conflicting demanding letters from people when they get into repayment because the one group doesn't know what the other group is doing.

The idea of the data base is being a one centralized place. It wouldn't matter if you went to five colleges. You, William D. Ford with my Social Security number would end up in the same common data base.

Mr. Hough. That's correct.

Chairman FORD. Which doesn't now happen.

Mr. HOUGH. That's correct. The next to the last requirement on a promissory note that goes with every guaranteed student loan, right above where the borrower signs it, is a requirement that he undertakes to keep the lender advised as to where he is, what his address is, what school he's enrolled at, and whether he's enrolled on an eligible basis.

That's seemingly simple enough, but as you just recited, we make it incredibly difficult. Loans move from holder to holder. The student doesn't really know exactly to whom to communicate in all instances. The data base is aimed at getting past that and adding reliability and a bit of convenience.

Chairman FORD. Thank you very much.

Ms. DONG. Mr. Ford, I don't necessarily want to prolong this, but I would like to associate myself with the comments about doing this improved communication sharing among all the different agencies, lenders and institutions. We agree that students fall between the cracks because there isn't enough information continuing after they graduate.

But I would just like to comment briefly on how there needs to be that personal touch. And I know that it's certainly within your concern but maybe not within your committee's jurisdiction, but there needs at institutions to be more time for financial aid counselors to sit down with students.

At George Washington University, they expect students to get information about this very complex system from the two college work studies which are set up, like, put out in the front desk to be sitting ducks and have to answer all these questions.

There's no replacement for time spent with a financial aid officer who knows this system. And by the same token, this exit counseling. You know, we appreciate the videos. And this is very difficult for me because I don't want to make it sound like students are stupid and, like, don't realize the seriousness of taking out a loan and need to have, you know, brightly colored brochures and need to have their hands held.

But for many students, this is the first financial decision they will ever make on their own. And many of them, especially first generation college students like the African American student is student president of Chicago State University who testified at Mr. Hayes' field hearing, once he got there, breaking all these barriers and being told by his community that he was selling out, he was going to take that $2,500 loan because he got this far. He's going to take it. And he didn't even know he was supposed to pay it back once he dropped out temporarily.

And exit counseling, they literally say, "Oh, here. Here's a little piece of paper. Go to the library." They make you walk down to the library, you watch this video, and then you sign it. They don't know if you've actually seen it, and just nothing, nothing can replace having a conversation with someone who knows the system and can impart to you the seriousness of taking out a loan. There's just no replacement for it.

And that's our concern. And so we certainly want to work with this committee to insure that information is given.

And about employer relief, my organization has had a number of students turn down jobs with us. We pay $15,000 a year. Students who have loans can't afford to take jobs with us, but we can't afford to pay off their loans. So we've lost a lot of good students who could be up here agitating and bothering you other than me.

So we want to work on these issues with you, and thank you for your concern.

Chairman FORD. Thank you very much. I'm enjoying this but it's been a long time, so the committee will stand adjourned.

[Whereupon, at 1:05 p.m., the subcommittee was adjourned, subject to the call of the Chair.]

HEARING ON THE REAUTHORIZATION OF THE HIGHER EDUCATION ACT OF 1965

WEDNESDAY, JUNE 12, 1991.

House of Representatives,
Subcommittee on Postsecondary Education,
Committee on Education and Labor,
Washington, DC.

The subcommittee met, pursuant to call, at 9:30 a.m., Room 2175, Rayburn House Office Building, Hon. William D. Ford [Chairman] presiding.

Members present: Representatives Hayes, Sawyer, Andrews, Jefferson, Reed, Coleman, Klug, Goodling, Petri, Gunderson, and Barrett.

Staff present: Thomas Wolanin, staff director; Jack Jennings, education counsel; Maureen Long, legislative associate; Gloria Gray-Watson, administrative assistant; Brent Lamkin, staff assistant; Jo-Marie St. Martin, minority education counsel; and Rose DiNapoli, minority professional staff member.

Chairman Ford. I am pleased to convene the Subcommittee on Postsecondary Education for this, the twentieth of our 46—that number keeps going up—46 hearings on the reauthorization of the Higher Education Act.

Today is our second of three hearings on the Stafford Loan Program which provides almost four million students and their parents with guaranteed loans to help finance postsecondary education; $4.24 billion in Federal appropriations generated almost $12 billion in loan capital this year.

Our witness this morning will present new approaches to Federal lending, and I am pleased that a distinguished member of this subcommittee, Tom Petri of Wisconsin, will testify this morning in support of his legislation, H.R. 2336, the Income Dependent Education Assistance Act.

We will also hear testimony regarding other alternatives to the current Stafford Loan Program, including direct lending.

I look forward to hearing the comments and suggestions of our witnesses.

Without objection, the prepared statements of the witnesses will be inserted in full in the record immediately following their oral comments.

Mr. Coleman?

Mr. Coleman. I have no statement.

Chairman Ford. All right.

Mr. Petri, it is all yours.

STATEMENT OF THE HONORABLE THOMAS E. PETRI, U.S. HOUSE OF REPRESENTATIVES

Mr. PETRI. Thank you very much, Mr. Chairman.

The Higher Education Act has been called by some the most important social legislation to come before the 102nd Congress, and I certainly share that opinion.

In our country we have the preeminent system of higher education in the entire world, and our job during this reauthorization is to keep it that way and to make certain that all Americans have access to that system of higher education. This is a challenging mandate under ideal circumstances, but more challenging given our current budget situation.

With this in mind I along with Representative Sam Gejdenson of Connecticut and 23 other cosponsors have introduced the Income-Dependent Education Assistance Act, or the IDEA Act for short.

The IDEA Act sets up a supplementary direct student loan program in which repayment is based on the borrower's income after school and is collected as personal income tax by the IRS. The basic principle behind it is that education represents, at least in part, an investment. Students are investing in human capital when they pay tuition, and they expect a return on that investment in the form of higher future incomes.

Under IDEA, the government backs such investment in human capital and in exchange receives a participating interest in the returns to that capital. When we do that, it turns out that this approach enables us to achieve a large number of important advantages.

In the first place IDEA is clearly fairer than the Stafford Loan Program. IDEA repayment is geared exclusively to ability to pay whereas Stafford is actually regressive. Under Stafford, the students who stay in school for the longest time, and therefore on average have the highest later incomes, pay the lowest effective interest rates on their loans because they get the most benefit from their school interest subsidy.

The second major advantage of the IDEA approach is that it provides a better deal for students than Stafford, Spplementary Loans for Students, or HEAL. For most students in 4 year programs the cost of an IDEA loan is approximately equivalent to that of Stafford, but the IDEA loan provides the added advantages of insurance against low income, ease of repayment through the income tax system, and complete flexibility of repayment that accommodates life changes like unemployment, periods of child rearing, divorce or death of a spouse, low earnings right after school, or periods of low wage public service employment.

For shorter term students, IDEA is a better deal even in terms of cost, or effective interest rate paid. Even for graduate students IDEA can still be a better overall deal.

The third major advantage of IDEA is that it solves the middle income access problem that we have all been wrestling with. We all know that it would cost a ton of money to open up eligibility for Stafford loans to all students regardless of family income, but when you turn things around and look at the problem from the IDEA perspective, the whole picture changes. Under IDEA you actually want students from higher income families to participate because they tend to have higher later incomes themselves, and some of them will make limited premium interest payments that help to subsidize the low income borrowers.

A fourth major advantage of IDEA is that it rationalizes and dramatically simplifies the whole question of deferments and forgiveness provisions that, under the current system, constitute a sometimes arbitrary, unfair and complex mess that is next to impossible to keep track of.

Under IDEA everyone who needs a deferment because of temporary low income, or forgiveness because of permanently low income, automatically gets it with no fuss and no extra recordkeeping, and we in the Congress don't have to argue about which occupations are more or less deserving.

The fifth IDEA advantage is that it solves the problem of what to do about the severely troubled HEAL program for medical professions students. The IDEA Act does not repeal HEAL, which is not under the jurisdiction of our committee, but it should largely drive HEAL out of business because it is a much more attractive program for those students who typically face extreme problems of immense loan repayment burdens and insufficient income shortly after leaving school.

The final IDEA advantage I would like to mention is that this approach should save immense amounts of money, possibly billions of dollars per year, and this is a crucial point. If we want to spend more money on Pell grants or other parts of the Higher Education Act, and I for one do, we have got to find savings elsewhere, and IDEA is a perfect source because it saves tremendous amounts of money while still providing a much better loan program than the ones we have now.

At this point, you might ask how this is possible. How can we save money while providing a fairer and better deal for students, solving the HEAL and middle income access problems, and providing universal deferment and forgiveness according to need? The answer is that there are four major sources of efficiency in IDEA that correspond to four sources of waste in Stafford and other current loan programs.

The first of these is that IDEA practically eliminates defaults. There is no reason to default because repayment is based on ability to pay and is capped at a reasonable percentage of income. There is no opportunity to default because the repayment is part of one's income taxes.

This alone is a potential source of savings on the order of a billion dollars plus. And even though I am proposing IDEA only as a supplementary program, note that the bill does provide that all new Stafford and HEAL loan agreements will carry a stipulation that if those loans go into default, they will be converted automatically into IDEA loans and become subject to IRS collection under the IDEA terms. In that way IDEA will reduce default costs even under the programs that coexist with it.

The second major source of efficiency is a lower cost of capital. Whereas existing programs use private capital at politically negotiated interest rates, IDEA uses government capital at a cost equivalent to the interest paid on government bonds of comparable maturity which will be much lower. That is another billion dollar potential source of savings at no cost to students.

A third source of efficiency in IDEA is precise targeting of subsidies. IDEA provides subsidies to all those who need them, only to those who need them, and to the extent of their need. It pays for these subsidies, at least partly, from limited premium interest payment, from high income graduates; that is, from those whose investments in education have paid off most handsomely. That is exactly the reverse of the Stafford program, which on average subsidizes high income graduates in preference to low income borrowers who have low incomes in many cases precisely because they didn't graduate or invested only in shorter term programs.

The fourth and final source of IDEA efficiency is simplified administration. Loan origination is simple because there are no extra institutions involved and because there is no needs analysis. Anyone attending an approved school is eligible regardless of family income. Loan collection is also as simple as it can be. Since the IRS is already in the tax collection business, and repayment is included as personal income tax liability, the added cost of the program would be negligible.

No additional tax returns are generated, as those who fall below the filing threshold, and therefore owe no regular income taxes, owe no additional IDEA payments either. In fact, IDEA should simplify the job of the IRS because it will get the IRS out of the business of withholding the refunds of loan defaulters.

In short, we have created a loan program which increases the availability of funding, reduces default, and makes repayment more manageable. To the extent that subsidies are involved, they are progressive, and the money goes where it should go, to students who need it rather than to bankers, defaulters, administrators, and the richest graduates. In the process IDEA frees up a great deal of Federal money which can be used for education grants, work study, or for deficit reduction.

I have been very encouraged that there seems to be a good deal of open mindedness on both sides of the aisle concerning reauthorization of the Higher Education Act. Clearly, the time has come to fix the problems inherent in the current law rather than continuing to tinker around.

The IDEA Act provides an innovative and cost effective way to ensure access to higher education for all students, and I encourage my colleagues to study this initiative and to support it.

I would like to submit materials describing the IDEA Act and ask that they be included in the hearing record, and I would be happy to answer any questions that anyone might have.

[The prepared statement of Hon. Thomas E. Petri follows:]

Testimony Before the
Subcommittee on Postsecondary Education
Committee on Education and Labor
U.S. House of Representatives

by

The Honorable Thomas E. Petri, M.C.

Wednesday, June 12, 1991

9:30 a.m.

Mr. Chairman:

I would like to thank you and my distinguished colleagues on this subcommittee for inviting me to testify today. Reauthorization of the Higher Education Act has been called by some "the most important social legislation to come before the 102nd Congress". I share this opinion. In the United States, we have the pre-eminent system of higher education in the world. Our job during this reauthorization is to keep it that way, and to make certain that all Americans have access to the system.

That is a challenging mandate under ideal circumstances, but more challenging given our current budget situation. With this in mind, I, along with Representative Gejdenson and 23 other cosponsors, have introduced the Income-Dependent Education Assistance Act, or the IDEA Act for short.

The IDEA Act sets up a supplementary direct student loan program, in which repayment is based on the borrower's income after school, and is collected as personal income tax by the IRS. The basic principle behind it is that education represents, at least in part, an investment. Students are investing in human capital, and they expect a return on that investment in the form of higher future incomes. Under IDEA, the government backs such investments in human capital and in exchange receives a participating interest in the returns to that capital. In effect, students borrow against their future income streams. On an individual basis, students can't finance education in this way, because they can't pledge their human capital as collateral and each individual can't guarantee a particular level of return on his or her investment. But collectively financing education on the basis of pooled risk and return on investments is a sound governmental approach to student aid. The IDEA program takes that sound approach from theory to practice.

When we do that, it turns out that this approach enables us to achieve a large number of important advantages. In the first place, IDEA is clearly fairer than the Stafford loan program. IDEA repayment is geared explicitly to ability to pay, whereas Stafford is actually regressive. Under Stafford the students who stay in school for the longest time, and therefore have the HIGHEST later incomes, pay the LOWEST effective interest rates on their loans because they get the most benefit from the in school interest subsidy.

A second major advantage of the IDEA approach is that it provides a better deal than Stafford, SLS, or HEAL for most students. For most students in four year programs, the COST of IDEA loans is approximately equivalent to that of Stafford, but the IDEA loan provides the added advantages of insurance against low income, ease of repayment through the income tax, and complete flexibility of repayment that accommodates life changes like unemployment, periods of child rearing, divorce or death of a spouse, low earnings right after school, or periods of low wage public service employment. For shorter term students, IDEA is a better deal even in terms of cost, or effective interest rate paid. Even for graduate students, IDEA can still be a better overall deal, especially for borrowing during the graduate years.

A third major advantage of IDEA is that it solves the middle income access problem we've all heard about. We all know that it would cost a ton of money to open up eligibility for Stafford loans to all students regardless of family income. But when you turn things around and look at the problem from the IDEA perspective, the whole picture changes. Under IDEA you actually want students from higher income families to participate because they tend to have higher later incomes themselves and some of them will make limited premium interest payments that help to subsidize low income borrowers.

A fourth major advantage of IDEA is that it rationalizes and dramatically simplifies the whole question of deferments and forgiveness provisions that, under the current system, constitute an arbitrary, unfair, complex mess that's next to impossible to keep track of. Under IDEA, everyone who needs a deferment because of temporarily low income, or forgiveness because of permanently low income, automatically gets it, with no fuss and no extra record keeping. And we in the congress don't have to argue about which occupations are more or less deserving.

A fifth IDEA advantage is that it solves the problem of what to do about the severely troubled HEAL program for medical professions students. The IDEA act does not repeal HEAL, which is not under the jurisdiction of our committee, but it should largely drive HEAL out of business because it is much more attractive for those students, who typically face extreme problems of immense loan repayment burdens and insufficient income shortly after leaving school.

The final IDEA advantage I'd like to mention is that this approach should save immense amounts of money, possibly in the billions of dollars per year. That is a crucial point. If we want to spend more money on Pell grants or other parts of the Higher Education Act, we've got to find savings somewhere, and IDEA is a perfect source because it saves these tremendous amounts while still providing a much better loan program than the ones we've got now.

You might well ask at this point how this is possible. How can we save money while providing a fairer and better deal for students, solving the HEAL and middle income access problems, and providing universal deferment and forgiveness according to need? The answer is that there are four major sources of efficiency in IDEA that correspond to four sources of waste in Stafford and other current loan programs.

The first of these is that IDEA practically eliminates defaults. There is no reason to default because repayment is based on ability to pay and is capped at a reasonable percentage of income. And there is no opportunity to default because the repayment is part of one's income taxes. This alone is a potential source of savings on the order of a billion dollars plus. And even though I am proposing IDEA only as a supplementary program, note that the bill does provide that all new Stafford and HEAL loan agreements will carry a stipulation that if those loans go into default, they will be converted automatically into IDEA loans and become subject to IRS collection under the IDEA terms. In that way, IDEA will reduce default costs even under the programs that coexist with it.

The second major source of efficiency is a lower cost of capital. Whereas existing programs use private capital at politically negotiated interest rates, IDEA uses government capital at a cost equivalent to the interest paid on government bonds of comparable maturity, which will be much lower. That's another billion dollar potential source of savings at no cost to students. While it may appear that this source can be tapped with a non-income-dependent direct loan approach, such as those you will hear about from other witnesses this morning, those proposals suffer from potential collection problems. Only the IDEA-type approach justifies collection as income taxes by the IRS, which solves the collection problems associated with direct government loans.

A third source of efficiency in IDEA is precise targeting of subsidies. IDEA provides subsidies to all those who need them, only to those who need them, and to the extent of their need. It pays for those subsidies, at least partly, from limited premium interest payments from high income graduates -- that is, from those whose investments in education have paid off most handsomely. That's exactly the reverse of the Stafford program, which, on average, subsidizes high income graduates in preference to low income borrowers, who have low incomes in many cases precisely because they didn't graduate or invested only in shorter term programs.

The fourth and final source of IDEA's efficiency is simplified administration. Loan origination is simple because there are no extra institutions involved and because there is no needs analysis. Anyone attending an approved school is eligible regardless of family income.

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Loan collection is also as simple as it can be. Since the IRS is already in the tax collection business, and repayment is included as personal income tax liability, the added costs to the program would be negligible. No additional tax returns are generated, as those who fall below the filing threshold, and therefore owe no regular income taxes, owe no additional IDEA payments either. In fact, IDEA should simplify the job of the IRS, because it will get the IRS out of the business of withholding the refunds of loan defaulters.

In short, we have created a loan program which increases the availability of funding, reduces defaults, and makes repayment more manageable.

To the extent that subsidies are involved, they are progressive. And the money goes where it should go -- to students who need it -- rather than to bankers, defaulters, administrators, and the richest graduates.

In the process, IDEA frees up a great deal of federal money which can be used for education grants or for deficit reduction.

I have been very encouraged that there seems to be a good deal of openmindedness on both sides of the aisle concerning reauthorization of the Higher Education Act. Clearly the time has come to fix the problems inherent in the current law, rather than continuing to tinker around. The IDEA Act provides an innovative and cost-effective way to ensure access to higher education for all students, and I encourage my colleagues to study this initiative and support it.

I would like to submit materials describing the IDEA Act and ask that they be included in the hearing record.

IDEA COMPARED TO STAFFORD LOANS

Assume: Stafford borrowers pay up-front fees of 8%; therefore they need to borrow $108.70 to get $100 to use (.92 x $108.70 = $100);
IDEA interest charged (from day one) is 8% (i.e.t-bill rates = 6%):
Four-year student borrows to spend $14,000 as follows: $2000 in year 1, $3000 in year 2, $4000 in year 3, and $5000 in year 4.

In-School Account Histories

	Stafford		IDEA		
Date	Add to Acc't	Total Owed	Added to Account	Total Owed	Notes
9-1-1	$1087		$1000		semester 1, yr 1 loan
12-31-1			26.40		interest - 4 mo., 8%
2-1-2	1087		1000		loan: sem. 2, yr. 1
9-1-2	1631		1500		loan: sem. 1, yr. 2
12-31-2			32.11		12 mo. int. on $1026.40
"			73.33		int.: 11 mo./$1000
"			39.60		" 4 mo./$1500
"		$3805		$3721.44	
2-1-3	1630		1500		loan
9-1-3	2174		2000		"
12-31-3			297.72		int.: 12 mo./$3721.44
"			110.00		" 11 " / 1500
"			52.80		" 4 " / 2000
"		7609		7681.96	
2-1-4	2174		2000		loan
9-1-4	2718		2500		"
12-31-4			614.56		int.: 12 mo./$7681.96
"			146.66		" 11 " / 2000
"			66.00		" 4 " / 2500
"		12,501		13,009.18	
2-1-5	2717		2500		loan: sem. 2, yr. 4
6-1-5			433.64		int.: 5 mo./$13,009.18
"			66.00		" 4 " / 2500
"		15,218		16,008.82	

Stafford final total = 8.7% more than $14,000; IDEA total = 14.3% more.

BUT, the Stafford borrower repays his loan at a higher effective interest rate, averaging about 8 5/8%, versus 8% for most borrowers under IDEA. The Stafford monthly payment of $189.74 would actually repay $15,638 worth of loans at 8%. So the IDEA loans are $370.82 (plus repayment period interest) more expensive than the Stafford loans. But the IDEA borrower receives complete repayment flexibility, low income protection, and ease of application (with no needs analysis and no need to go to a bank.

Clearly, IDEA should be the loan of choice for many 4-year students. It is actually less expensive for virtually all those in shorter programs, and it is still attractive for many graduate students, especially those with borrowing concentrated in the graduate years.

IDEA COMPARED TO HEAL

An 8% insurance premium is deducted from HEAL loans up front. Therefore, you must borrow $108.70 to get $100 to use for education.

HEAL loans are charged variable interest from day one at the average 91 day t-bill rate plus 3% (rounded up to the nearest 1/8 %, which the following analysis ignores). Interest payment is deferred and capitalized while the student is in school and for up to 4 years of residency.

BUT, that interest is charged on the whole $108.70.

The EFFECTIVE interest rate paid based on the $100 actually used varies with the number of years the loan is outstanding before repayment begins. Assuming 6% t-bill rates and a 10 year repayment period, these effective rates are as follows:

Years	% Premium Over T-bills
1	4 5/8% -
2	about 4 3/8%
3	4 1/4% -
4	4% +
5	4% -
6	about 3 7/8%
7	3 3/4% +
8	3 3/4% -

IDEA borrowers pay no up-front fees, are charged standard interest of 2% over the t-bill rate, and face the possibility of paying premium interest of up to a maximum of 4.5% over the t-bill rate (if their incomes are especially high in the first 12 years after school), or paying subsidized interest at rates all the way down to zero or below if their incomes are low over a 25 year period after school.

Therefore, the STANDARD cost of a HEAL loan is only slightly less than the MOST you can pay under IDEA (and note that the longer your residency, the fewer high earning years you have in which to pay premium interest during your first 12 post-school years under IDEA).

AND, IDEA offers other advantages, including:

complete flexibility (payments always limited as % of income),
low income protection,
high interest protection (interest can never go over 12.5%, no matter what happens to t-bills in any year; HEAL has no upper limit on interest).

IN SUM, IDEA should be the loan of choice for virtually all well-advised medical professions students.

Yet IDEA still should save taxpayers money due primarily to a lower cost of capital and the virtual elimination of defaults.

IDEA ACT - SYNOPSIS

The IDEA Act creates a new supplementary student loan program in which repayments are determined by post-school income of the borrower and are collected by the IRS as part of the individual income tax. The program avoids taxpayer subsidies but does contain an internal cross-subsidy from those with very high incomes to those with very low incomes. Essential features follow:

* Students may borrow up to $70,000 total ($6,500 for each of the first two years undergraduate, $8,000 for third and later years, $11,000 per year graduate), but any amounts borrowed under other federal programs are subtracted from these limits. The $70,000 limit is phased out between age 35 and 55 so that borrowers do not assume obligations disproportionate to their remaining earning years. There are higher limits for certain medical professions.

* Borrowers' accounts are charged interest each year at the average 91 day T-bill rate for the year plus 2%, but in no case more than 10%. There are no up-front fees (i.e. for "loan origination" or insurance).

* For a given account balance, the annual repayment amount for a given year varies according to income. Progressivity is derived from the income tax rates applicable to single and married taxpayers before tax reform.

* Most borrowers will pay off IDEA loans at the T-bill plus 2% rate in 12 to 18 years. However, borrowers with high post-graduation incomes who finish repayment within 12 years can pay up to 2 1/2 points more than the interest originally charged to their accounts, while low income borrowers will have any unpaid portions of their loans forgiven after 25 years.

* No borrower will owe payments for any year in which his income is below the tax return filing threshold ($10,900 for joint returns and $6,050 for single returns in 1993). Any borrower's total payments are capped by a percentage of his income that rises gradually as income rises (generally below 15% at a moderate income level). Along with the progressivity in the normal repayment schedules, this assures borrowers that their payments will be manageable, regardless of job changes, unemployment, retraining, homemaking, etc.

* No means tests restrict IDEA borrowing. They would not reduce government costs and would prevent participation by future high income earners.

* All those needing "deferments" to enter low-paying public service jobs automatically receive them. No need for complex deferment schemes.

* Borrowers may voluntarily convert any Stafford and HEAL debt to IDEA loans of the same origination date. New Stafford and HEAL loans that go into default will be converted automatically to IDEA loans.

* IDEA repayment obligations may not be discharged in a bankruptcy proceeding.

* Borrowing limits and repayment schedules are indexed for inflation.

IDEA ACT - BASIC ELEMENTS

LOAN LIMITS

$6,500 for first two years undergrad, $8,000 for third & later years, and $11,000 per year for graduate students, less amounts borrowed under other federal programs; cumulative limit of $70,000; higher limits for certain medical professions schools.

INTEREST

Interest charged to borrowers' accounts each year at lesser of 10% or 2% over the average 91-day T-bill rate for that year; no extra origination fees or insurance premiums.

No in-school interest subsidy or in-school interest payments; interest accrued while in school is added to principal for later payment.

REPAYMENT

After leaving school, each year borrowers find repayment amounts from simple tables with income on one axis, maximum account balances on the other axis; total payments are capped at 20% of the difference of income minus the relevant income tax filing threshold ($10,900 joint or $6,050 single in 1993).

For given account balance, standard payment (made by singles between $31,380 and $37,740 and couples between $39,060 and $48,600) would pay off account balance in 12 years if T-bill + 2% rates average 8%.

For given account balance, payment at lowest incomes is a bit less than 1/2 the standard payment, payment at highest incomes is twice the standard payment; most people repay loans in 12 to 18 years.

Progressivity of tables derived from pre '86 income tax rate schedules.

Stafford or HEAL loans may be converted to IDEA; cap on total annual payments applies to converted loans.

Repayment ends whenever account balance is paid off at actual T-bill plus 2% variable rates charged to account, or upon death or disability, except:

> Any unpaid balance is forgiven after 25 years of repayment, and
>
> Borrowers must make payments for at least 12 years, except:
>
> > Borrower is finished paying in less than 12 years when cumulative payments pay off account at effective variable interest rate (called "buyout rate") of T-bill plus 4 1/2%

INCOME DEPENDENT EDUCATION ASSISTANCE (IDEA): Repayment by Unmarried Taxpayers

Income:		6050	10000	15000	20000	25000	30000	35000	40000	50000	75000	100000	168000
(1) progessivity factor		0.467	0.513	0.600	0.769	0.867	0.971	1.000	1.035	1.161	1.359	1.539	2.000
(2) annual payment per $10,000 maximum account balance (MAB)		$0	$681	$796	$1020	$1151	$1289	$1327	$1373	$1541	$1803	$2042	$2654
(3) (a) maximum annual payment		$0	$790	$1790	$2790	$3790	$4790	$5790	$6790	$8790	$13790	$18790	$32390
(b) amount in (3)(a) as percent of income		0.0	7.9	11.9	14.0	15.2	16.0	16.5	17.0	17.6	18.4	18.8	19.3
(c) MAB at which (3)(a) is reached		N. A.	$11601	$22487	$27353	$32928	$37161	$43632	$49454	$57041	$76484	$92018	$122042
(4) years required to pay back loan at indicated interest rates	6%		36	24	15	12.5	11-	10+	10-	8.5	7-	6	4.5
	8%			50+	20	15+	13-	12	11+	9.5	8-	7-	5-
	10%				41	21	16+	15-	13.5	11	8.5	7	5
	12%									13+	10-	8-	5.5

(1) based upon income level of borrower; derived from pre '86 income tax rate structure and specified in the IDEA Act.
(2) line (2) = line (1) x $1327; MAB is highest amount of unpaid principal and accrued interest during the history of a borrower's IDEA account.
(3)(a) line (3)(a) = 20% of (MAGI minus $6,050). $6,050 is the tax filing threshold for joint returns in 1993.
(3)(c) line (3)(c) = ((3)(a) divided by line (2)) x $10,000.
(4) numbers higher than 25 are illustrative only, since borrowers are excused from any remaining obligation after 25 years; since the standard interest charges are capped at 10%, the 12% line is of interest only with respect to potential high income premiums.

INCOME DEPENDENT EDUCATION ASSISTANCE (IDEA): Repayment by Taxpayers Filing Joint Returns

Income:		10900	15000	20000	25000	30000	35000	40000	50000	75000	100000	160000	240000
(1) progessivity factor		0.485	0.546	0.618	0.734	0.843	0.932	1.000	1.014	1.210	1.311	1.477	2.000
(2) annual payment per $10,000 maximum account balance (MAB)		$0	$725	$820	$974	$1119	$1237	$1327	$1346	$1606	$1740	$1960	$2654
(3) (a) maximum annual payment		$0	$820	$1820	$2820	$3820	$4820	$5820	$7820	$12820	$17820	$29820	$45820
(b) amount in (3)(a) as percent of income		0	5.5	9.1	11.3	12.7	13.8	14.6	15.6	17.1	17.8	18.6	19.1
(c) MAB at which (3)(a) is reached		N.A.	11310	22195	28953	34138	38965	43858	58098	79826	102414	152143	172645
(4) years required to pay back loan at indicated interest rates	6%		30	22.5	16	13	11.5	10+	10	8	7+	6+	4.5
	8%				22.5	16+	13.5	12	12-	9	8	7-	4.5
	10%					24	17+	14.5	14+	10+	9	7.5	5
	12%									12+	10+	8+	5+

(1) based upon income level of borrower; derived from pre '86 income tax rate structure and specified in the IDEA Act.

(2) this figure = line (1) x $1327; MAB is highest amount of unpaid principal and accrued interest during the history of a borrower's IDEA account.

(3)(a) line (3)(a)=20% of (MAGI minus $10,900). $10,900 is the tax filing threshold for joint returns in 1993.

(3)(c) line (3)(c)= ((3)(a) divided by line (2)) x $10,000.

(4) numbers higher than 25 are illustrative only, since borrowers are excused from any remaining obligation after 25 years; since the standard interest charges are capped at 10%, the 12% line is of interest only with respect to potential high income premiums.

102D CONGRESS
1ST SESSION

H. R. 2336

To establish a higher education loan program in which a borrower's annual repayment obligation is dependent upon both postschool income level and borrowing history, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

MAY 14, 1991

Mr. PETRI (for himself, Mr. GEJDENSON, Ms. MOLINARI, Mr. INHOFE, Mr. SANTORUM, Mr. PORTER, Mr. LAFALCE, Mr. LANCASTER, Mr. SUNDQUIST, Mr. NUSSLE, Mr. HORTON, Mr. MCCOLLUM, Mr. HUGHES, Mr. HERTEL, Mr. CAMPBELL of Colorado, and Mr. DE LUGO) introduced the following bill; which was referred jointly to the Committees on Education and Labor and Ways and Means

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A BILL

To establish a higher education loan program in which a borrower's annual repayment obligation is dependent upon both postschool income level and borrowing history, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Income-Dependent Education Assistance Act of 1991".

TITLE I—SYSTEM FOR MAKING INCOME-DEPENDENT EDUCATION ASSISTANCE LOANS

SEC. 101. PROGRAM AUTHORITY.

The Secretary of the Treasury shall, in accordance with the provisions of this title—

(1) make loans to eligible students in accordance with this title, and

(2) establish an account for each borrower of such a loan, and collect repayments on such loans, in accordance with section 6306 of the Internal Revenue Code of 1986.

SEC. 102. AGREEMENTS BY ELIGIBLE INSTITUTIONS.

(a) TERMS OF AGREEMENT.—In order to qualify its students for loans under this title, an eligible institution shall enter into an agreement with the Secretary of Education which—

(1) provides that the institution will collect applications for loans under this title from its students that are in such form and contain or are accompanied by such information as the Secretary of the Treasury may require by regulation;

(2) contains assurances that the institution will, on the basis of such applications, provide to the Secretary of the Treasury the information required by

section 104 and will certify to the Secretary of the Treasury—

(A) the cost of attendance determination for each student; and

(B) the amount of any outstanding loans to such student under title IV of the Higher Education Act of 1965 or title VII of the Public Health Service Act;

(3) provides that the institution will provide to each student applying for a loan under this title a notice provided by the Secretary of Education of the student's obligations and responsibilities under the loan;

(4) provides that, if a student withdraws after receiving a loan under this title and is owed a refund—

(A) the institution will pay to the Secretary of the Treasury a portion of such refund, in accordance with regulations prescribed by the Secretary of the Treasury to ensure receipt of an amount which bears the same ratio to such refund as such loan bore to the cost of attendance of such student; and

(B) the Secretary of the Treasury will credit the amount of such refund to the student's account; and

(5) contains such additional terms and conditions as the Secretary of the Treasury or Secretary of Education prescribes by regulation to protect the fiscal interest of the United States and to ensure effective administration of the program under this Act.

(b) ENFORCEMENT OF AGREEMENT.—The Secretary of Education may, after notice and opportunity for a hearing to the institution concerned, suspend or revoke, in whole or in part, the agreement of any eligible institution if the Secretary of Education finds that such institution has failed to comply with this title or any regulation prescribed under this title or has failed to comply with any term or condition of its agreement under subsection (a). No funds shall be loaned under this title to any student at any institution while its agreement is suspended or revoked, and the Secretary of Education may institute proceedings to recover any funds held by such an institution. The Secretary of Education shall have the same authority with respect to his functions under this Act as the Secretary of Education has with respect to his functions under part B of title IV of the Higher Education Act of 1965.

(c) NOTICE TO SECRETARY.—The Secretary of Education shall annually submit to the Secretary of the Treasury a list of the eligible institutions having effective agreements under this section, and shall promptly notify the Secretary of the Treasury of any action taken under subsection (b) to suspend, revoke, or reinstate any such agreement.

SEC. 103. AMOUNT AND TERMS OF LOANS.

(a) ELIGIBLE AMOUNTS.—

(1) ANNUAL LIMITS.—Any individual who is determined by an eligible institution to be an eligible student for any academic year shall be eligible to receive an IDEA loan for such academic year in an amount which is not less than $500 or more than the cost of attendance at such institution, determined in accordance with section 484 of the Higher Education Act of 1965. The amount of such loan shall not exceed—

(A) $6,500 in the case of any student who has not completed his or her second year of undergraduate study;

(B) $8,000 in the case of any student who has completed such second year but who has not completed his or her course of undergraduate study;

(C) $30,000 in the case of any student who is enrolled in a graduate degree program in medicine, dentistry, veterinary medicine, podiatry, optometry, or osteopathic medicine; or

(D) $22,500 in the case of any student who is enrolled in a graduate degree program in pharmacy, chiropractic, public health, health administration, clinical psychology, or allied health fields, or in an undergraduate degree program in pharmacy; or

(E) $11,000 in the case of any other student.

(2) LIMITATION ON BORROWING CAPACITY.—No individual may receive any amount in an additional IDEA loan if the sum of the original principal amounts of all IDEA loans to such individual (including the pending additional loan) would equal or exceed—

(A) $70,000, minus

(B) the product of (i) the number of years by which the borrower's age (as of the close of the preceding calendar year) exceeds 35, and (ii) one-twentieth of the amount specified in subparagraph (A), as adjusted pursuant to paragraph (3).

(3) EXCEPTIONS TO BORROWING CAPACITY LIMITS FOR CERTAIN GRADUATE STUDENTS.—For a student who is—

(A) a student described in paragraph (1)(C), paragraph (2) shall be applied by substituting "$143,370" for "$70,000"; or

(B) a student described in paragraph (1)(D), paragraph (2) shall be applied by substituting "$115,770" for "$70,000".

(4) ADJUSTMENT OF LIMITS FOR INFLATION.—Each of the dollar amounts specified in paragraphs (1), (2), and (3) shall be adjusted for any academic year after calendar year 1994 by the cost-of-living adjustment for the calendar year preceding such academic year determined under section 6306(h)(3)(C) of the Internal Revenue Code of 1986, rounded to the nearest multiple of $100 (or, if such adjustment is a multiple of $50 and not a multiple of $100, such adjustment shall be increased to the next higher multiple of $100).

(5) COMPUTATION OF OUTSTANDING LOAN OBLIGATIONS.—For the purposes of this subsection, any loan obligations of an individual under student loan programs under title IV of the Higher Education Act of 1965 or title VII of the Public Health

Service Act shall be counted toward IDEA annual and aggregate borrowing capacity limits. For purposes of annual and aggregate loan limits under any such student loan program, IDEA loans shall be counted as loans under such program.

(6) ADJUSTMENTS OF ANNUAL LIMITS FOR LESS THAN FULL-TIME STUDENTS.—For any student who is enrolled on a less than full-time basis, loan amounts for which such student shall be eligible for any academic year under this subsection shall be reduced in accordance with regulations prescribed by the Secretary of Education.

(b) DURATION OF ELIGIBILITY.—An eligible student shall not be eligible to receive a loan under this title for more than a total of the full-time equivalent of 9 academic years, of which not more than the full-time equivalent of 5 academic years shall be as an undergraduate student and not more than the full-time equivalent of 5 academic years shall be as a graduate student.

(c) TERMS OF LOANS.—Each eligible student applying for a loan under this title shall sign a written agreement which—

(1) is made without security and without endorsement, except that if the borrower is a minor and such note or other written agreement executed

by him would not, under the applicable law, create a binding obligation, endorsement may be required,

(2) provides that such student will repay the principal amount of the loan and any interest or additional charges thereon in accordance with section 6306 of the Internal Revenue Code of 1954;

(3) provides that the interest on the loan will accrue in accordance with section 105;

(4) certifies that the student has received and read the notice required by section 102(a)(3); and

(5) contains such additional terms and conditions as the Secretary of the Treasury may prescribe by regulation.

(d) DISBURSEMENT OF PROCEEDS OF LOANS.—The Secretary of the Treasury shall, by regulation, provide for the distribution of loans to eligible students and for the appropriate notification of eligible institutions of the amounts of loans which are approved for any eligible student, and for the allocation of the proceeds of such loan by semester or other portion of an academic year. The Secretary of the Treasury shall distribute the proceeds of loans under this title by disbursing to the institution a check or other instrument that is payable to and requires the endorsement or other certification by the student. Such proceeds shall be credited to any obligations of the eligible student to the institution related to the cost of attendance at such institution, with any excess being paid to the student. The first installment of the proceeds of any loan under this title that is made to a student borrower who is entering the first year of a program of undergraduate education, and who has not previously obtained a loan under this title, shall not be presented by the institution to the student for endorsement until 30 days after the borrower begins a course of study, but may be delivered to the eligible institution prior to the end of that 30-day period.

SEC. 104. INFORMATION REQUIREMENTS FOR LOAN PROGRAM.

(a) RESPONSIBILITIES OF ELIGIBLE INSTITUTIONS.—Each eligible institution which receives funds under this title shall—

(1) submit to the Secretary of the Treasury, at such time and in such form as the Secretary may require by regulation, a machine-readable list of applicants and the amounts for which they are qualified under section 103;

(2) promptly notify the Secretary of the Treasury, on request, of any change in enrollment status of any recipient of a loan under this title; and

(3) submit to the Secretary of the Treasury, at such time and in such forms as the Secretary of the Treasury may require by regulation for use in determining the repayment status of borrowers, a machine-readable list of eligible students who have previously received loans under this title but who are not included as current applicants in the list required by such paragraph.

(b) RESPONSIBILITIES OF THE SECRETARY OF THE TREASURY.—The Secretary of the Treasury shall, on the basis of the lists received under subsection (a)(2), establish an obligation account, by name and taxpayer identification number, with respect to each recipient of a loan under this title. The Secretary of the Treasury shall provide for the increase in the total amount stated for each such account by any amounts subsequently loaned to that recipient under this title and by the amount of any interest charges imposed pursuant to section 105. The Secretary of the Treasury shall, with the notice required by section 6306(a)(1) of the Internal Revenue Code of 1986, transmit to each recipient of a loan under this title a statement of the total amount of the obligation of such recipient as of the close of the preceding calendar year.

SEC. 105. INTEREST CHARGES.

Interest charges on loans made under this title shall be added to the recipient's obligation account at the end of each calendar year. Such interest charges shall be based upon an interest rate equal to the lesser of—

(1) the sum of the average bond equivalent rates of 91-day Treasury bills auctioned during that calendar year, plus 2 percentage points, rounded to the next higher one-eighth of 1 percent; or

(2) 10 percent.

SEC. 106. CONVERSION AND CONSOLIDATION OF OTHER LOANS.

(a) IN GENERAL.—The Secretary of the Treasury may, upon request of a borrower who has received a federally insured or guaranteed loan or loans under title IV of the Higher Education Act of 1965 or under title VII of the Public Health Service Act, make a new loan to such borrower in an amount equal to the sum of the unpaid principal on the title IV or title VII loans. The proceeds of the new loan shall be used to discharge the liability on such title IV or title VII loans. Except as provided in subsection (b), any loan made under this subsection shall be made on the same terms and conditions as any other loan under this Act and shall be considered a new IDEA loan for purposes of this title and section 6306 of the Internal Revenue Code of 1986.

(b) Conversion Regulations.—The Secretary of the Treasury shall prescribe regulations concerning the methods and calculations required for conversion to IDEA loans under subsection (a). Such regulations shall provide appropriate adjustments in the determination of the principal and interest owed on the IDEA loan in order to—

(1) secure payments to the Government commensurate with the amounts the Government would have received had the original loans been IDEA loans;

(2) fairly credit the borrower for principal and interest payments made on such original loans and for origination fees deducted from such original loans; and

(3) prevent borrowers from evading their obligations or otherwise taking unfair advantage of the conversion option provided under this section.

(c) Mandatory Conversion of Defaulted Loans.—

(1) Conversion in accordance with regulations.—Any loan which is—

(A) made, insured, or guaranteed under title IV of the Higher Education Act of 1965 or title VII of the Public Health Service Act after the date of enactment of this Act, and

(B) assigned to the Secretary of Education or Health and Human Services for collection after a default by the borrower in repayment of such loan,

shall, in accordance with regulations prescribed by the Secretaries of Education and Health and Human Services, be treated for purposes of collection, under section 6306 of the Internal Revenue Code of 1986, as if such loan had been converted to an IDEA loan under subsections (a) and (b) of this section.

(2) NOTICES.—The Secretaries of Education and Health and Human Services shall notify—

(A) the Secretary of the Treasury of the need to establish or adjust an account balance of any borrower by reason of the provisions of this subsection; and

(B) the borrower of the conversion of the defaulted loans to an IDEA loan and of the procedures for collection under section 6306 of the Internal Revenue Code of 1986.

SEC. 107. TERMINATION OF OTHER STUDENT LOAN PROGRAMS.

The authority to make additional loans under section 428A and part D of title IV of the Higher Education Act of 1965 (20 U.S.C. 1078–1) is terminated for any academic year beginning after the date that regulations are prescribed by the Secretaries of the Treasury and Education to carry out this title. This section shall not affect the administration of such section and part with respect to loans made prior to that date.

SEC. 108. AUTHORIZATION OF APPROPRIATIONS.

(a) LOAN FUNDS.—There are authorized to be appropriated to make distributions of loan funds under section 102 such sums as may be necessary.

(b) ADMINISTRATIVE EXPENSES.—There are authorized to be appropriated such sums as may be necessary to administer and carry out this title.

SEC. 109. DEFINITIONS.

For purposes of this title—

(1) the term "eligible institution" has the meaning given it by section 435(a) (1) or (2) of the Higher Education Act of 1965;

(2) the term "eligible student" means a student who is eligible for assistance under title IV of the Higher Education Act of 1965 as required by section 484 of such Act (relating to eligibility for student assistance) and who is carrying at least one-half the normal full-time academic workload (as determined by the institution); and

(3) the term "IDEA loan" means a loan made under this title.

TITLE II—COLLECTION OF INCOME-DEPENDENT EDUCATION ASSISTANCE LOANS

SEC. 201. REPAYMENTS USING INCOME TAX COLLECTION SYSTEM.

(a) IN GENERAL.—Subchapter A of chapter 64 of the Internal Revenue Code of 1986 (relating to collection) is amended by adding at the end thereof the following new section:

"SEC. 6306. COLLECTION OF INCOME-DEPENDENT EDUCATION ASSISTANCE LOANS.

"(a) NOTICE TO BORROWER.—

"(1) IN GENERAL.—During January of each calendar year, the Secretary shall furnish to each borrower of an IDEA loan notice as to—

"(A) whether the records of the Secretary indicate that such borrower is in repayment status,

"(B) the maximum account balance of such borrower,

"(C) the current account balance of such borrower as of the close of the preceding calendar year, and

"(D) the procedure for computing the amount of repayment owing for the taxable year beginning in the preceding calendar year.

"(2) FORM, ETC.—The notice under paragraph (1) shall be in such form as the Secretary may by regulations prescribe and shall be sent by mail to the individual's last known address or shall be left at the dwelling or usual place of business of such individual.

"(b) COMPUTATION OF ANNUAL REPAYMENT AMOUNT.—

"(1) IN GENERAL.—The annual amount payable under this section by the taxpayer for any taxable year shall be the lesser of—

"(A) the product of—

"(i) the base amortization amount, and

"(ii) the progressivity factor for the taxpayer for such taxable year, or

"(B) 20 percent of the excess of—

"(i) the modified adjusted gross income of the taxpayer for such taxable year, over

"(ii)(I) in the case of a joint return, the sum of the standard deduction applicable to such return and twice the exemption amount for the taxable year, and

"(II) in any other case, the sum of the standard deduction applicable to such individual and the exemption amount for the taxable year.

For purposes of subparagraph (B)(ii), the term 'standard deduction' has the meaning given such term by section 63(c), and the term 'exemption amount' has the meaning given such term by section 151(d).

"(2) BASE AMORTIZATION AMOUNT.—

"(A) IN GENERAL.—For purposes of this section, the term 'base amortization amount' means the amount which, if paid at the close of each year for a period of 12 consecutive years, would fully repay (with interest) at the close of such period the maximum account balance of the borrower. For purposes of the preceding sentence, an 8-percent annual rate of interest shall be assumed.

"(B) JOINT RETURNS.—In the case of a joint return where each spouse has an account balance and is in repayment status, the amount determined under subparagraph (A) shall be

196

the sum of the base amortization amounts of each spouse.

“(3) Progressivity factor.—

“(A) In general.—For purposes of this section, the term ‘progressivity factor’ means the number determined under tables prescribed by the Secretary which is based on the following tables for the circumstances specified:

“(i) Joint returns; surviving spouses.—In the case of a taxpayer to whom section 1(a) applies—

“If the taxpayer’s modified adjusted gross income is:	The progressivity factor is:
Not over $7,860	0.429
11,700	0.500
16,740	0.571
21,720	0.643
26,880	0.786
32,700	0.893
39,060	1.000
48,600	1.000
63,480	1.152
87,360	1.272
117,000	1.364
163,080	1.485
240,000 and over	2.000

“(ii) Heads of households.—In the case of a taxpayer to whom section 1(b) applies—

“If the taxpayer’s modified adjusted gross income is:	The progressivity factor is:
Not over $6,540	0.429
10,320	0.500
12,300	0.607
16,080	0.643
19,920	0.714
25,020	0.857
31,380	1.000

37,740	1.000
47,280	1.094
63,180	1.313
85,440	1.406
114,060	1.500
204,000 and over	2.000

"(iii) UNMARRIED INDIVIDUALS, ETC.—In the case of a taxpayer to whom section 1(c) applies—

"If the taxpayer's modified adjusted gross income is:	The progressivity factor is:
Not over $6,540	0.467
9,000	0.500
11,580	0.533
14,220	0.600
16,740	0.667
19,920	0.767
25,020	0.867
31,380	1.000
37,740	1.000
45,360	1.118
58,080	1.235
82,260	1.412
94,320	1.500
168,000 and over	2.000

"(iv) MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—In the case of a taxpayer to whom section 1(d) applies—

"If the taxpayer's modified adjusted gross income is:	The progressivity factor is:
Not over $3,930	0.483
5,850	0.552
8,370	0.655
10,860	0.759
13,440	0.862
16,350	1.000
19,530	1.000
24,300	1.182
31,740	1.333
43,680	1.485
84,000 and over	2.000

"(B) RATABLE CHANGES.—The tables prescribed by the Secretary under subparagraph

(A) shall provide for ratable increases (rounded to the nearest 1/1,000) in the progressivity factors between the amounts of modified adjusted gross income contained in the tables.

"(C) INFLATION ADJUSTMENT OF MODIFIED AGI AMOUNTS.—For inflation adjustment of amounts of modified adjusted gross income, see subsection (h)(3).

"(4) MODIFIED ADJUSTED GROSS INCOME.—For purposes of this subsection, the term 'modified adjusted gross income' means adjusted gross income for the taxable year—

"(A) determined without regard to section 62(b) and without regard to the deductions from gross income allowable under section 62(a) by reason of—

"(i) paragraph (6) thereof (relating to profit-sharing, annuities, and bond-purchase plans of self-employed individuals),

"(ii) paragraph (7) thereof (relating to retirement savings), and

"(iii) paragraph (11) thereof (relating to reforestation expenses), and

"(B) increased by—

"(i) interest exempt from the tax imposed by chapter 1, and

"(ii) the items of tax preference described in section 57 (other than subsection (a)(5) thereof).

"(c) TERMINATION OF BORROWER'S REPAYMENT OBLIGATION.—

"(1) IN GENERAL.—The repayment obligation of a borrower of an IDEA loan shall terminate only if there is repaid with respect to such loan an amount equal to—

"(A) in the case of any repayment during the first 12 years for which the borrower is in repayment status with respect to any loan, the sum of—

"(i) the principal amount of the loan, plus

"(ii) interest computed for each year the loan is outstanding at an annual rate equal to the annual rate otherwise applicable to such loan for such year, plus 2.5 percent, and

"(B) in the case of any repayment during any subsequent year, the principal amount of the loan plus interest computed at the rates applicable to the loan.

"(2) NO REPAYMENT REQUIRED AFTER 25 YEARS IN REPAYMENT STATUS.—No amount shall be required to be repaid under this section with respect to any loan for any taxable year after the 25th year for which the borrower is in repayment status with respect to such loan.

"(3) EXCEPTION FOR DE MINIMUS LOANS REPAID DURING FIRST 12 YEARS IN REPAYMENT STATUS.—In any case where the maximum account balance of any borrower is $3,000 or less, subparagraph (B), and not subparagraph (A), of paragraph (1) shall apply to repayment of such loan.

"(4) DETERMINATION OF YEARS IN REPAYMENT STATUS.—For purposes of paragraphs (1)(A) and (2), the number of years in which a borrower is in repayment status with respect to any IDEA loan shall be determined without regard to any year before the most recent year in which the borrower received an IDEA loan.

"(5) EXTENSION OF REPAYMENT YEARS FOR MEDICAL INTERNS.—The number of years specified in paragraphs (1)(A) and (2) shall be increased by 1 year for each calendar year during any 5 months of which the individual is an intern in medicine, dentistry, veterinary medicine, or osteopathic medicine.

"(d) DEFINITIONS.—For purposes of this section—

"(1) MAXIMUM ACCOUNT BALANCE.—The term 'maximum account balance' means the highest amount (as of the close of any calendar year) of unpaid principal and unpaid accrued interest on all IDEA loan obligations of a borrower.

"(2) CURRENT ACCOUNT BALANCE.—The term 'current account balance' means the amount (as of the close of a calendar year) of unpaid principal and unpaid accrued interest on all IDEA loans of a borrower.

"(3) REPAYMENT STATUS.—A borrower is in repayment status for any taxable year unless—

"(A) such borrower was, during at least 7 months of such year, an eligible student, as that term is defined in section 109(3) of the Income-Dependent Education Assistance Act of 1991; or

"(B) such taxable year was the first year in which the borrower was such an eligible student and the borrower was such an eligible student during the last 3 months of such taxable year.

"(4) IDEA LOAN.—The term 'IDEA loan' means any loan made under title I of the Income-Dependent Education Assistance Act of 1991.

"(e) PAYMENT OF AMOUNT OWING.—Any amount to be collected from an individual under this section shall be paid—

"(1) not later than the last date (determined without regard to extensions) prescribed for filing his return of tax imposed by chapter 1 for the taxable year ending before the date the notice under subsection (a) is sent, and

"(2)(A) if such return is filed not later than such date, with such return, or

"(B) in any case not described in subparagraph (A), in such manner as the Secretary may by regulations prescribe.

"(f) FAILURE TO PAY AMOUNT OWING.—If an individual fails to pay the full amount required to be paid on or before the last date described in subsection (e)(1), the Secretary shall assess and collect the unpaid amount in the same manner, with the same powers, and subject to the same limitations applicable to a tax imposed by subtitle C the collection of which would be jeopardized by delay.

"(g) LOANS OF DECEASED AND PERMANENTLY DISABLED BORROWERS; DISCHARGE BY SECRETARY.—

"(1) DISCHARGE IN THE EVENT OF DEATH.—If a borrower of an IDEA loan dies or becomes permanently and totally disabled (as determined in accordance with regulations of the Secretary), then the Secretary shall discharge the borrower's liability on the loan.

"(2) LIMITATION ON DISCHARGE.—The discharge of the liability of an individual under this subsection shall not discharge the liability of any spouse with respect to any IDEA loan made to such spouse.

"(h) CREDITING OF COLLECTIONS; SPECIAL RULES.—

"(1) CREDITING OF AMOUNTS PAID ON A JOINT RETURN.—Amounts collected under this section on a joint return from a husband and wife both of whom are in repayment status shall be credited to the accounts of such spouses in the following order:

"(A) first, to repayment of interest added to each account at the end of the preceding calendar year in proportion to the interest so added to the respective accounts of the spouses, and

"(B) then, to repayment of unpaid principal, and unpaid interest accrued before such preceding calendar year, in proportion to the respective maximum account balances of the spouses.

"(2) COMPUTATION OF ALTERNATIVE ANNUAL PAYMENT FOR INDIVIDUALS WHO HAVE ATTAINED AGE 55.—In the case of an individual who attains age 55 before the close of the calendar year ending in the taxable year, or of an individual filing a joint return whose spouse attains age 55 before the close of such calendar year, the progressivity factor applicable to the base amortization amount of such individual for such taxable year shall not be less than 1.0.

"(3) INFLATION ADJUSTMENT IN COMPUTATION OF PROGRESSIVITY FACTOR.—

"(A) IN GENERAL.—Not later than December 15 of 1996 and of each 3d calendar year thereafter, the Secretary shall prescribe tables which shall apply in lieu of the tables contained in subsection (b)(3)(A) with respect to the succeeding 3 calendar years.

"(B) METHOD OF PRESCRIBING TABLES.—The table which under subparagraph (A) is to apply in lieu of the table contained in clause (i), (ii), (iii), or (iv) of subsection (b)(3)(A), as the case may be, shall be prescribed—

"(i) by increasing each amount of modified adjusted gross income in such table by the cost-of-living adjustment for the calendar year, and

"(ii) by not changing the progressivity factor applicable to the modified adjusted gross income as adjusted under clause (i).

If any increase under the preceding sentence is not a multiple of $10, such increase shall be rounded to the nearest multiple of $10 (or, if such increase is a multiple of $5 and is not a multiple of $10, such increase shall be increased to the next highest multiple of $10).

"(C) COST-OF-LIVING ADJUSTMENT.—For purposes of this paragraph, the cost-of-living adjustment for any calendar year is the percentage (if any) by which—

"(i) the CPI for the preceding calendar year, exceeds

"(ii) the CPI for the calendar year 1995.

"(D) CPI FOR ANY CALENDAR YEAR.—For purposes of subparagraph (C), the CPI for any calendar year is the average of the Consumer Price Index as of the close of the 12-month period ending on September 30 of such calendar year.

"(E) CONSUMER PRICE INDEX.—For purposes of subparagraph (D), the term 'Consumer Price Index' means the last Consumer Price Index for all-urban consumers published by the Department of Labor.

"(5) RULES RELATING TO BANKRUPTCY.—

"(A) IN GENERAL.—An IDEA loan shall not be dischargeable in a case under title 11 of the United States Code.

"(B) CERTAIN AMOUNTS MAY BE POSTPONED.—If any individual receives a discharge in a case under title 11 of the United States Code, the Secretary may postpone any amount of the portion of the liability of such individual on any IDEA loan which is attributable to amounts required to be paid on such loan for periods preceding the date of such discharge.

"(6) FINALITY OF ASSESSMENT AND COLLECTION.—The first sentence of subsection (b) of section 6305 shall apply to assessments and collections under subsection (f) of this section."

(b) APPLICATION OF ESTIMATED TAX.—Subsection (f) of section 6654 of such Code (relating to failure by individual to pay estimated income tax) is amended by striking "minus" at the end of paragraph (2) and inserting "plus", by redesignating paragraph (3) as paragraph (4), and by inserting after paragraph (2) the following new paragraph:

"(3) the amount required to be repaid under section 6306 (relating to collection of income-dependent education assistance loans), minus."

(c) FILING REQUIREMENT.—Subsection (a) of section 6012 of such Code (relating to persons required to make returns of income) is amended by inserting after paragraph (9) the following new paragraph:

"(10) Every individual required to make a payment for the taxable year under section 6306 (relating to collection of income-dependent education assistance loans)."

(d) CLERICAL AMENDMENT.—The table of sections for subchapter A of chapter 64 of such Code is amended by adding at the end thereof the following new item:

"Sec. 6306. Collection of income-dependent education assistance loans."

Chairman **Ford**. Thank you very much. You have obviously given this a great deal of thought and put a lot of work in it, Mr. Petri. Have you any idea what the reaction of Treasury will be to this proposal?

Mr. **Petri**. The income tax provisions in our bill have meant a referral to Ways and Means. They should be interested in supporting it because they could realize some savings for their part of the budget as well.

IRS always opposes additional responsibilities. During the last reauthorization, when we discussed this with the IRS, it was not supportive, but the IRS is now in the business of collecting student loans, in part, by offsetting the tax refunds of those in default, so from IRS's point of view, this may actually simplify what it is already doing. The IRS will do what we tell it at the end of the day.

Chairman **Ford**. Well, Tom, isn't that really one of the big differences between what we are doing now and what you are proposing, that the money owed by a student under your proposal becomes a new form of tax liability?

Mr. **Petri**. Right.

Chairman **Ford**. Collectible the same, presumably, as all other tax liabilities, by IRS.

Mr. **Petri**. Right.

Chairman **Ford**. That is a higher order of indebtedness than the student now has when they go into default or even if they are paying.

Mr. **Petri**. Right.

Chairman **Ford**. When IRS is collecting at the present time, it is only responsible for withholding from money that would otherwise be refunded for advance payment of taxes to a citizen. It isn't responsible for collecting an additional tax. That raised the question in my mind, and I have asked Tom to check with the Parliamentarian to see if we accepted an amendment of this kind, if that would mean that this bill went from this committee to Ways and Means; and if it goes from this committee to Ways and Means, you and I will be very old, indeed, before we ever see it again.

Mr. **Petri**. Well, we have proposed this as a supplemental bill and so it need not——

Chairman **Ford**. Well, if we could take it outside of reauthorization so it doesn't contaminate the package and get into the wrong—it is a nice committee over there, but not very friendly to education.

Mr. **Petri**. I would be happy to go over some of the details with you. We think that the Education Committee would end up, from a budget point of view, realizing significant savings that it could apply to other education accounts, and that the Ways and Means Committee would also realize some savings for its accounts which might make it amenable to signing off on this provision.

Chairman **Ford**. The Ways and Means Committee would get the credit for the money we saved in the budget process, and we would still have to go take our money from our own people.

Thank you very much.

Mr. Coleman?

Mr. **Coleman**. Mr. Chairman, I want to join you in commending our colleague, Mr. Petri, who is certainly an active member of the subcommittee. Tom, you have obviously spent a lot of time and effort on this. I think it is good that we have your proposal before us so we may look at it. I thank you for bringing this to our attention today, and we will be discussing it, but I appreciate all of your hard work I know went into this.

Mr. Petri. Thank you.

Mr. Coleman. Thank you.

Chairman Ford. Mr. Andrews?

Mr. Andrews. No questions.

Chairman Ford. Mr. Klug?

Mr. Klug. Let me join the other members on the committee if I can, Tom, just to say that I think this is a terrific idea, and I think you put together something that a lot of us can be supportive of down the road.

What do you think last time out didn't help you get as much support for it as you had hoped on the first run?

Mr. Petri. Well, I think that people thought the Stafford program was in better shape than we have since learned, and we weren't then under the same budget pressure as we are now. And at that time the way things were scored for budget purposes was different, so that if the government had directly borrowed money and used it for a program such as this, it would have ended up being listed as an expense.

Now, because of the savings and loan and other crises, they have changed the way they score that. We had proposed at that time that it be financed in the bond market by private bonds rather than directly by government bonds, and there were a lot of technical difficulties in trying to engineer a package that would, in fact, be attractive in the private bond market and be salable. When the new budget agreement came out this fall, we discovered that direct Federal lending was no longer an impediment.

So now I think you will see, for a variety of reasons, a lot of interest in some kind of a direct loan program. It can help us in our budget accounts. It may help us solve the means test problem which is a big bone of contention for middle income people, and is very unfair in a lot of individual circumstances.

There are five or six proposals out there backed by people across the political spectrum. We are certainly eager to work with others on the committee and in the community to put together a package that would, in fact, get the job done as responsibly as possible.

There are some things we may not have thought of, but I think there may be some features that we have thought of and some questions and changes that we would suggest to some of the other packages that have come forward, and we would all benefit by working together on it.

Mr. Klug. Excuse me, is there any cap on the back end? Do you have to pay it by a certain period of time? I mean, is 20 years the outside?

Mr. Petri. You have to pay for no more than 25 years, after which it is forgiven. You can't squeeze blood out of a turnip, and at that stage in people's lives they are going to have to be providing for their retirement, so we phase out the amount you can borrow as you get older in age to avoid people borrowing a lot and then not being able to repay.

Mr. Klug. Thank you.

Chairman Ford. Thank you very much.

The next panel will be Ms. Patricia Smith, Director of Legislative Analysis, American Council on Education, Washington, DC.; Mr. Joe Belew, President, Consumer Bankers Association, Arlington, Virginia; Mr. Thomas A. Butts, Associate Vice President for Government Relations, University of Michigan, Ann Arbor, Michigan; Reverend John P. Whalen, Chairman, University Support Services, Herndon, Virginia; and Mr. Donald A. Saleh, Director of Financial Aid and Student Employment, Cornell University, Ithaca, New York.

Mr. Saleh. Yes.

Mr. Andrews. Mr. Saleh will go first. He is from Cornell University in Ithaca, New York, where I went to school, so we will let him go first and begin from right to left.

I will note that your written statements, without objection, will be entered into the record. You can feel free to summarize from it if you so choose.

STATEMENTS OF DONALD A. SALEH, DIRECTOR OF FINANCIAL AID AND STUDENT EMPLOYMENT, CORNELL UNIVERSITY; JOHN P. WHALEN, CHAIRMAN, UNIVERSITY SUPPORT SERVICES; THOMAS A. BUTTS, ASSOCIATE VICE PRESIDENT FOR GOVERNMENT RELATIONS, UNIVERSITY OF MICHIGAN; JOE BELEW, PRESIDENT, CONSUMER BANKERS ASSOCIATION; AND PATRICIA SMITH, DIRECTOR OF LEGISLATIVE ANALYSIS, AMERICAN COUNCIL ON EDUCATION

Mr. Saleh. Thank you. Let me reintroduce myself. My name is Don Saleh. I am the Director of Financial Aid and Student Employment at Cornell University in Ithaca, New York, and I am here today to represent the Consortium on Financing Higher Education which is an organization representing 32 high tuition private colleges and universities.

Before I start my testimony I would like to thank, in abstentia, Mr. Ford for his wisdom and good judgment as it pertains to issues regarding higher education, and in particular with issues regarding financial aid. His long term commitment and intellectual leadership are both appreciated by members of our consortium and the financial aid community throughout the country.

To put my comments in a little bit of context for you, I would like to describe for you our membership or the policies of our membership.

Our institutions generally follow principles of need based financial aid. Our commitment to need based aid is demonstrated by the fact that 45 percent of our undergraduate students receive need based aid. Virtually all of these students receive loans and work as a part of their financial aid package, and almost all receive grants, either from Federal, State, or institutional sources, and while each of the components is important, it is the availability of student loans, especially the Stafford loan, that allows us to continue our current financial aid programs.

It is because of the importance of access to student credit that I appreciate the opportunity to appear before you today with several suggestions to make loan programs more responsive to the needs of our students, the institutions, and taxpayers.

Our goals are twofold. First, we seek in working with the committee to restore the integrity to the student loan system; and second, to expand student credit without overburdening taxpayers. Both concerns require maintenance and alterations to existing programs and present opportunities for implementing new ideas.

The first specific proposal that I would like to recommend deals with expansion of student borrowing limits within the Stafford Loan Program. We recommend that the limits be raised to $4,000 for students in their first 2 years of undergraduate study, $6,000 for upper division students, and $10,000 for graduate and professional school students.

These increases will help keep pace with inflation and will continue the viability of this crucial component of student aid. They will also allow independent colleges and universities like ours to maintain their strong commitment to need based financial aid.

I believe that without these increases many schools like Cornell would be forced to reduce the number of students receiving need based financial aid as we channel even greater portions of our own resources to help meet the needs of the students that we do fund.

Second, I want to commend the department for its efforts to promulgate regulations designed to restore integrity to the Stafford Loan Program. However, these regulations have created a significant and unwarranted burden on some institutions. At Cornell, for example, our students borrow in excess of $35 million a year at the graduate and undergraduate level through the Stafford Loan Program, and we have a calculated default rate of less than 1 percent per year.

It doesn't make sense to us that the same regulations being drawn up to control the problems demonstrated at institutions that have difficulty administering the programs, that have high default rates, would be applied to institutions that are doing a good job administering the programs and have low default rates.

We believe that the legislation should be written in such a way that it encourages the development of performance based regulations which would encourage institutions to do a good job of administering the Federal aid programs and to find ways to keep default rates for their students at a low level. These schools would then be rewarded by having lower levels of regulatory burden.

The third proposal that we make is for an expansion of the Perkins Loan Program in a way that would require no new Federal allocations. We recommend that institutions be allowed to expand their matching share of Federal dollars from one-ninth to one-half with a similar increase in lending limits for those individual students.

This change would allow institutions the flexibility to use this low interest loan program to meet the borrowing needs of its lowest income students, and I believe that this would allow us to help control the amount of debt these students would incur, would keep their payments after graduation at a low level, and would allow institutions to work individually with their own graduates to keep them on a repayment cycle.

Fourth, I want to lend our support to efforts under way to increase access to more middle income families to the Stafford Loan Program. Currently, more and more middle income families see their choices shrinking in regards to higher education. It is very important that we continue to provide students with both access and choice, and we commend the current efforts, particularly those under way by Congressmen Williams and Gephardt, to examine the problem and expand middle income access to the loan programs.

Finally, I want to talk about two items which the committee has heard before, one which you will hear more extensively about being direct lending. This is an idea that intrigues us at Cornell and I know intrigues other members of our consortium. We look at it as an opportunity for the Federal Government to more directly channel funds to students, its financial aid funds to students, and an opportunity to use the excess or any savings—I am sorry, any savings—to provide increased grants to low income students.

If this were done, then that would have a rebound effect because we know that low income students have the most difficulty after graduation in staying on a payment schedule. If we can maintain a lower loan level for those students by increasing Pell grants, then we would also decrease default rates and further provide savings to the Stafford program.

Some of the members of our consortium have worked with Mr. Butts and others in discussing this program and this idea, and I assure you that we will continue to do that, and our interest in talking with any members of the committee or their staff regarding direct lending, and I also assure you that members of our group, including Cornell, are interested in participating in an optional direct lending program.

Finally, I would like to comment on a proposal brought before the committee on May 9 by Dennis Martin, the Director of Financial Aid at Washington University in St. Louis. At that time Mr. Martin proposed the creation of a national college savings bank. This is a program that we also believe warrants a good deal of study, and we find it very interesting.

Briefly, this proposal would attract capital from families wishing to save for the future education of their children and would recirculate that capital to the existing guaranteed student loan program which is Loans to Students. If the families could be encouraged to save by providing competitive interest for those moneys and possibly a tax break, we think that the opportunity would be there to raise substantial capital, and there would be a profit, if you would, between the amount we pay depositors and the amount we collect back on loans.

This savings could be used in one of two ways; either to create default reserve to again lower the cost of the program to the Federal Government or to provide the profit as a way of further subsidizing the Pell grant program and further providing grant aid to low income students.

I want to thank the committee for the opportunity to present my views. Thank you for having me go first, and I look forward to answering any questions that you may have.

[The prepared statement of Donald A. Saleh follows:]

STATEMENT OF

DONALD A. SALEH
DIRECTOR OF FINANCIAL AID AND STUDENT EMPLOYMENT
CORNELL UNIVERSITY
ITHACA, NEW YORK

ON BEHALF OF

THE CONSORTIUM ON FINANCING HIGHER EDUCATION

BEFORE THE

SUBCOMMITTEE ON POSTSECONDARY EDUCATION
COMMITTEE ON EDUCATION AND LABOR
U.S. HOUSE OF REPRESENTATIVES

Mr. Chairman and distinguished Members of the Subcommittee:

My name is Donald A. Saleh and I am director of financial aid and student employment at Cornell University in Ithaca, New York. I appreciate this opportunity to appear before you today on behalf of the Consortium on Financing Higher Education, or COFHE, where I serve as chairman of its Reauthorization Task Force. The Consortium is a membership organization of 32 higher-tuition independent colleges and universities, a common characteristic which defines both our membership and our agenda. As such, we rely heavily on the Stafford loan program to help our students meet their self-help expectations and we are interested both in restoring integrity to this critical program and in various new initiatives that will continue to expand student credit without placing additional burdens on the taxpayer.

Before I begin my formal remarks concerning our views on changes to the federal loan programs, I would be remiss if I did not pause to say thank you, Mr. Chairman, for your wisdom, your good judgement, and most especially your intellectual leadership (as well as that of your able staff) in this process of reauthorizing the Higher Education Act. Five years ago, during the 1986 reauthorization debate on the floor of the House, one of your distinguished colleagues referred to you as a "legislator's legislator" as you and your able Republican counterpart, Mr. Coleman, steered that legislation toward final passage. We agree wholeheartedly with this tribute to your considerable talents and we salute you as one of the most loyal friends of higher education's in Congress.

Currently, our 32 institutions enroll approximately 115,000 undergraduates in traditional four-year degree programs. The financial aid policies at our institutions generally follow the principle that the family, to the extent that it is able, has the primary responsibility of paying for college: first by means of the parental contribution, and second via the student self-help contribution of loans and work (both term-time and summer). Forty-five percent of our students demonstrate financial need and virtually all of these students receive a need-based financial aid award package that includes a loan, a campus-based job, and a grant aid award.

In 1990-91, this meant that the approximately 52,000 needy undergraduate students at our member institutions received over $515 million in grant aid or an average grant of $9,950 per student. Of this $515 million, $23 million came from SEOG, $21 million from Pell, $61 million from state and outside grant programs, and $410 million, or 80% of the total, from the institutions themselves. The bulk of this institutional money (70%) is derived from current unrestricted (tuition) revenues. In other words, for every dollar of Pell grant or SEOG funds, our member institutions are supplying approximately twenty dollars of their own money towards undergraduate aid.

Thanks to the College Work-Study program, the average needy student also had a term-time job that earned him or her $1,500, he or she was expected to earn $1,400 over the summer, and he or she typically assumed an average annual loan burden of $3,560. Broken down by sources of aid, this translates to the following aid package for the typical COFHE undergraduate with need (a student from a family with two children, one in college, and a $44,000 income with no significant assets):

1990-91 Average COFHE Financial Aid Recipient

Average student self-help (work and loans)	$ 6,460
Average grant aid (institutional and government)	9,950
Average parental contribution	5,350
Average cost of attendance	$21,760

Although each component of the total aid package -- SEOG, Pell, CWS, state funds, institutional grants, and outside sources -- serves in its own indispensible way to help us meet the needs of our students, our enduring access to adequate credit through the federal loan programs, and most especially Stafford loans, is the critical element that allows us to continue meeting the financial aid requirements of our students. And it is because of this need for adequate access to student credit that we appreciate this opportunity to appear before you today with four specific suggestions to make federal loan policy more responsive to the needs of students, institutions, and taxpayers. These four suggestions involve: an increase in GSL loan limits, performance-based regulations for qualifying institutions, GSL eligibility for middle-income students, and increased NDSL loan limits via the institutional match. In addition, we wish to comment on two additional proposals that involve GSL reform and offer opportunities to move the program in new directions: the adoption of a direct lending option, and the implementation of a national savings program component.

First, Mr. Chairman, we recommend that annual Stafford loan program limits be increased to reflect the effects of inflation on current limits. But such increases should also be structured to reflect the substantial body of independent research that now indicates that students who persist toward their degree, particularly in four-year programs, are good credit risks. Accordingly, we have recommended increases to $4,000 in the first two years of school, $6,000 in the upperclass years and $10,000 per year for graduate school. Cumulative maximums would then become $26,000 for undergraduates and $76,000 for all GSL borrowing. In 1990-91, on average, students at the COFHE institutions were asked to assume a four-year debt burden of $14,250, an amount that may appear high, but our own research shows that aided students have assumed approximately the same 25% to 30% of total costs in self-help over the past fifteen years and without any significant adverse effect on defaults or career plans. (cf. A Visit with the Class of '89, COFHE, March 1991; and, The New England Loan Survey II, MHEAC, March 28, 1991.) Our research also shows that most of our institutions have policies that reduce the loan burden of our highest need students, a high proportion of whom come from underrepresented minority groups, by providing smaller loan packages.

Second, while we recognize and completely support the need for adequate regulation from the Department to insure program integrity, we are concerned that the growing number of oversight regulations has placed an increasing and unwarranted burden on schools such as ours. At Cornell, for example, our participation in the Stafford loan program is exemplary. Currently, our students receive approximately $35 million from this program annually and our default rate is under 1%. We feel strongly that institutions with a strong GSL track record should not be subject to all of the same onerous regulations that have been put in place in recent years to police those institutions that have difficulty in complying with program guidelines. We believe that it would be both fair and wise to establish a means of regulatory relief for those institutions that, by virtue of their meeting certain objective criteria, require less stringent (and less costly) Federal oversight. We believe that such "performance-based" regulations would also serve as an incentive for participating institutions at the margin to aspire to achieve those standards that trigger such regulatory relief with resulting benefits for all concerned.

Third, our research also shows that the growing plight of the middle-income student, an issue that has already surfaced in previous hearings, is real and must be addressed. All too often we see a two-earner family of modest means (as an example, parents who are secondary school teachers with a combined income of $80,000) with income sufficient to disqualify them from current federal programs. Several years ago, COFHE instituted a private supplemental loan program called SHARE which is similar in purpose to the ConSern program sponsored by Father Whelan's organization. But SHARE, of which we are justifiably proud, is not available directly to undergraduate students and requires a credit-worthy co-signer. While such programs provide much needed access to "liquidity borrowing," they cannot fulfill the borrowing needs of the teachers' child who cannot qualify for a GSL, nor were they meant to. We recommend, therefore, that there be a greater accommodation of the needs of middle-class students and families by expanding the eligibility limits of the Stafford loan program. We commend Congressman Williams for his leadership in this area and we support his efforts to make middle-income students eligible once again for need-based federal loans.

Finally, if I may deviate for a moment from today's primary focus on Stafford loans, I would like to emphasize that the Perkins (NDSL) loan program remains a critical source of additional capital that allows us the flexibility to award low-cost, direct loans to our neediest students. We are recommending that institutions with NDSL default rates lower than 7.5% be given the option of increasing their NDSL institutional match from 1/9th to 1/2, with a corresponding increase in lending limits, as a means of stretching the lending capacity of the program without additional cost to the federal government.

In addition to these four recommendations, there are two additional areas on which I would like to comment. Other distinguished panelists here today are presenting their views on the "direct lending" option for Stafford loans. We have found the NASULGC proposal that Mr. Butts and others have been working on a very interesting one. For almost as long as the GSL program has been around, a number of our member institutions at one time or another have had experience with being direct lenders under GSL with a result that was successful for both students and institutions. If direct lending can be demonstrated to have even modest revenue-saving consequences as a result of eliminating the special allowance, such savings can be redirected toward the Federal grant programs, resulting in lower default rates because the neediest students will not have to borrow as much. Thus, direct lending would appear to be an attractive option, not only because it saves money, but because it will help to restore integrity to a program that has received some well-deserved criticism in recent years.

While some of our member institutions support the notion of replacing GSL with the direct lending approach, the consensus of the COFHE membership is that, consistent with the ACE recommendation, an optional program of this nature should be given the chance to prove its effectiveness. I can assure you that a number of our member institutions, including Cornell, would be interested in becoming a participant in such an option. For institutions like Cornell that enroll students from virtually every state, direct lending would ease the administrative burden of dealing with 50 different guarantee agencies and thousands of different lenders, making the entire process a simplified one for students. A number of my colleagues have been actively engaged in discussing the development of the NASULGC plan and I am sure that these same individuals would be willing to work with you and your staff in further developing the direct lending concept.

Finally, Mr. Chairman, there is yet another approach to the GSL program that we believe offers a unique opportunity for innovation. COFHE has been actively engaged for a number of years in attempting to find ways of stimulating families to begin saving for college as early in the life of the child as possible. We were enthusiastic supporters of Mr. Williams' efforts to seek passage of the U.S. Savings Bond program and we continue to believe that more must be done to encourage pre-college family savings. Toward this end, we are supportive of a plan to charter a national college savings bank which was proposed in testimony by Dennis Martin of Washington University before this subcommittee on May 9, 1991. As you discuss the needs of middle-income families, we urge you to give priority to longer-term solutions that are implicit in creating a meaningful, well-planned national college savings program. Properly structured, such a program could become not only an incentive for middle-income families to save, but a national resource for pre-college plans aimed at lower-income students whose college aspirations can be significantly improved through various early intervention programs.

In Mr. Martin's testimony, he called for a national college savings bank whose mission would be to use the savings of parents of young children and lend it back to students in college today. Currently, the federal government guarantees lenders a rate of T-Bill plus 3.25%. Under this proposal, a related rate of interest tied to this fee (e.g., T-Bill plus 2%) would be paid to savers for future college expenses. One could also include the addition of a tax advantage and provide for the encouragement of savings deposits from private sector benefactors (including local governments) on behalf of young students. But the essential idea is to establish a means of combining the continuing interest in access to student credit with a meaningful savings incentive plan for parents and other interested parties in anticipation of future college needs. All of these goals we think can be accomplished without increased funding.

I thank you for this opportunity to appear before the committee to discuss our proposals for federal loan program reform and I would be happy to answer any questions you may have.

Mr. **Andrews**. Thank you very, very much. We are going to hear from each of the panelists before we go to questions from members, and we will next hear from Father John Whalen, Chairman of the University Support Services in Herndon, Virginia. Welcome, Father.

Reverend **Whalen**. Thank you very much, Mr. Chairman. I am very grateful to the committee for the opportunity to come here and to tell you a little bit about our program that we have started several years ago, and I must apologize in advance if I break in, all of a sudden, to profuse perspiration and uncontrolled trembling. It has nothing to do with the testimony. It is the world class challenge to an aging cleric to limit his remarks to 5 minutes.

And so I will go directly to the point here of where we would like to come out, not just University Support Services which is a nonprofit organization that, among other things, makes loans to middle class people to send their kids to school. It has another whole agenda in addition to that, but it is our chief occupation at the moment because we find that the need for it is so great that it occupies virtually all of our time and attention.

But why we really need to continue this program and to encourage other organizations such as ours to come into being to meet what could be in excess of a $60 billion a year need for cost of education for middle class people are basically two things. We need access to capital in a reliable way that is going to be there and that doesn't vary with the varying needs and agendas of profit making organizations such as international banks, underwriters, letter of credit banks, insurance companies, and the like.

And the second thing we need is a way to contain the cost of the program to middle class people by permitting a guarantee on the part of the Federal Government after a deductible to encourage this front end capital.

To repeat, we need access to capital, and looking around as to where that ought to come from and knowing the budget constraints and the desire of Congress not to add anything that is on budget, we would like this committee to approve our access and access to other organizations such as ours to Sallie Mae's warehousing advance program, and we like that of up to $1 billion a year for University Support Services, and I suspect it could run that high for other organizations that this would encourage to come into being.

The second thing we would like to ask you for is a Federal guarantee of middle income credit based loans such as ours over a 5 percent default rate. These two things, taken together, I am certain, would encourage well-meaning people all over the country to try to get into this program.

If I had to start all over again, I wouldn't do the program. It is just too hard. You have to deal with letter of credit banks and Wall Street, as I say, underwriters, insurance companies and the like, and I thought at one point I was a pretty good theologian and knew a lot about capital sins, and as a matter of fact, I did, but when it came to the sin of avarice I was absolutely green.

I may be the world's expert on that at the moment. I may know more now about the sin of avarice than any other theologian in the history of the world, including St. Augustine and St. Thomas Aquinas.

As I say, it is just too hard to do, to get something started with nothing, to provide a good thing for middle income people that is going to satisfy a national policy need.

Let me just say a word about the program that we put together. Our loan program is credit based. Virtually all of our borrowers are middle class people. Out of every hundred applications we get, we provide 65 percent loans; that is, 65 percent of our applications are honored by our making loans to people. Our default rate, after a 4 year experience, is .93 percent. We have a one page application. We have a five day turn-around on loans. We make loans of up to $25,000 a year for credit worthy people for a total of $100,000 over a 4 year period.

It has a 15 year payback which means that in repayment our loans have a lower monthly payment than the Stafford loans, and considerably lower than the PLUS and SLS loans. Our interest rate is commercial paper rates out of the Wall Street market plus 360 basis points, although it may be necessary to increase that spread a little bit because our cost of money is getting much higher, going back to the question of original and capital sins.

We have no subsidy whatsoever. There is not a nickel of government money in it. It is all market driven, and we started with no capital 4 years ago, and we now have made, over the past three lending seasons—we are in our fourth—over $200 million worth of loans to over 31,000 families across the country. We have made loans in every State and in all the territories.

The mechanics of the program are very complicated. When I first started, I looked around for the cheapest form of money I could find, and it turned out to be taxable commercial paper. So I wanted to issue our tax-exempt organizations taxable commercial paper on Wall Street so I went to a letter of credit bank up there to get a letter of credit. They said, "We will give it to you if you get an insurance policy to cover the loan portfolio."

I had to get insurance companies to cover the loan portfolio with insurance, but then they said they didn't want to take the first hit. They wanted a deductible. So I went back to the letter of credit bank and said, "I have got the insurance, the surety bond, but I have to over-issue commercial paper to fund it," and they said, "If the numbers work out right, we will do it." The numbers worked out right, and we got started about 3 years ago, as I say, making our first loans.

But every step of that way involves a lot of money, but even with that we are able to offer a low interest rate, long term loans to middle class people.

One of the ways that we decided to distribute information about our programs, since we didn't have any money for advertising or promotion, was through corporations, and we offered the program to corporations in return for a participation fee that basically pays for printing. We started to offer it to corporations about 3 years ago, and we now have 19,000 corporations signed up for it representing an employment base of about ten and a half million people.

Subsequently, we started a second program that we offer through colleges and universities. We now have 1500 colleges and universities that offer the program.

Our problem, however, has been our success. This year alone we expect to need between $200 million and $250 million to make loans to middle class people, and in dealing with Wall Street to raise this money, while it is possible, it takes virtually all the time of a whole staff of people to do that. We have a limited staff. We have originated $200 million of loans and maintained that portfolio with about 65 to 70 people whereas in the Stafford Loan Program, the Guaranteed Student Loan Programs, there are thousands of them.

Our cost of lending a dollar is about a nickel. The cost of the Stafford Loan Program of lending a dollar runs someplace between 37 and 40 cents, I think.

The solution to our problem, and part of the problem for middle class America, is to bring other organizations such as ours into being so that they can serve this enormous middle class need. They won't come into being if they have to do it the way I did. Nobody in his right mind would do that, and if I had to do it all over again, I wouldn't, not that my mind has cleared but I am just too tired to do it now.

I am sort of glad I did do it before I found out that you really can't do it that way.

So to bring other organizations such as ours into being, and to permit us to satisfy a growing need, and just to illustrate that need, our first year of lending we lent $3.4 million. Second year, $60 million. Third year, $120 million or more. This year so far it is in the $26 million range, and we haven't even started the season. We expect it to run, as I say, someplace between $200 million and $250 million, and the more people know about it, the more that they need it.

So two things I am asking for. One is access to Sallie Mae's warehousing advance program for us and for other organizations like us. Second, a Federal guarantee over a 5 percent default fund that we would provide that would make access to this front end capital available.

It is off budget. It safeguards the Federal Government because of this deductible. It offers savings to borrowers. It should be a named program. Programs such as this are now called supplemental student loan programs. The need is greater than the need for the population served by Stafford loans. It should be a named program such as Opportunity Loans or Productivity Loans or, better, named after a Member of Congress who has interest and has shown initiative in the Student Loan Program such as the Perkins Loans, the Stafford Loans, et cetera.

Thank you for putting up with what turns out to be about a 30 minute dissertation in 5 minutes. I appreciate it.

[The prepared statement of John P. Whalen follows:]

Testimony of University Support Services

205 Van Buren Street, Suite 200
Herndon, VA 22070
703/709-7880
to
Subcommittee on Postsecondary Education
by
Reverend John P. Whalen, Chairman and Ms. Catherine B. Dunlevy, President
June 12, 1991

Mr. Chairman and members of the sub-committee, my name is Reverend John P. Whalen and I am appearing here as Chairman and Founder of University Support Services. I am an aging, portly, cleri[illegible]ntleman but an agnostic with respect to the belief that has guided education policy in this country for the last ten years. I am a dangerous revolutionary. In 1986 I founded University Support Services ("USS"), which instituted its national program in 1987 to provide educational loans to credit worthy borrowers. With me is Catherine B. Dunlevy, President of our Company.

I greatly appreciate this opportunity to inform the committee of the progress we have made during the past three years in providing roughly $200,000,000 in educational loan financing to middle income Americans.

The University Support Services' program makes available loans of up to $25,000 annually, subject to costs of education at the selected college and certain credit criteria for an over-all limit of $100,000 of total program debt. Our loans are payable over a period of either twelve or fifteen years, depending upon the program used by the borrower. They bear interest at a rate that varies with our cost of financing and that is currently 9.52%. The

The long term, low interest rates applicable to our loans result in monthly payments that are among the lowest available to unsecured educational borrowers compared to other non-governmental, and some governmental programs. Borrowers may further reduce monthly payments by deferring principal during an in-school period of up to four years.

Our credit criteria have been developed by USS in conjunction with capital market participants that act as program credit providers. The credit criteria are conservative because we have had to rely on the strength of our loan portfolio to persuade credit providers to enter the program. Our net default rate is 0.93%, compared to 10.4% for the Federal Guaranteed Student Loan Program[1]. This low default rate is attributable, in part, to our credit criteria and, in part, to our rigorous administration of the loan program. We have developed loan servicing procedures that exceed our credit providers' requirements and that begin to address delinquency problems when loans are only 15 days delinquent. All of this has been accomplished entirely from private sources, without any governmental assistance whatsoever.

The appeal of the USS program to borrowers is evidenced by the fact that 58,672 applications requesting $452,951,709 have been received over our first four years of operation resulting in 30,995 loans in an aggregate amount of $193,919,033. Most importantly, as a result our conservative credit criteria, the USS program is truly a middle class program in that all loans have been directed to middle income borrowers.

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[1] FY 90 GSLP Data Book

	ANNUAL APPLICATION VOLUME		ANNUAL LOAN VOLUME	
CALENDAR YEAR	# OF LOANS (THOUSANDS)	$ AMOUNT (MILLIONS)	# OF LOANS (THOUSANDS)	$ AMOUNT (MILLIONS)
1987	1,190	9,735,014	527	3,401,555
1988	11,131	83,256,669	5,007	31,012,187
1989	18,571	147,837,422	10,008	61,596,540
1990	21,405	157,295,979	11,126	68,941,253
1991*	6,375	54,826,625	4,327	28,967,498
TOTAL:	58,672	$452,951,709	30,995	$193,919,033

*January through June to-date results only.

This record is not far behind the results achieved during the initial years of the federal SLS and PLUS programs. Moreover, we have developed the USS program without federal credit exposure and with no other form of public advertisement or subsidy. We now project loan volume for the 1991 calendar year to be in excess of 30,000 loans in an aggregate amount of at least $200,000,000.

In order to continue to meet borrower needs, however, USS must compete with such firms as General Motors, Ford, Sallie Mae, and with state and local borrowers whose debt benefits from federal tax exemption and with the federal government in gaining access to the capital markets. As a young program whose portfolio of loans is not sufficiently aged to be evaluated by the rating agencies on a stand alone basis, USS must "rent" credit from third parties and must recover the costs of such third-party credit from borrowers.

The loan program that USS has developed and administers works as follows. The majority of loan applications are received by USS from borrowers who are employed by one of roughly 18,000 corporate participants, each of which pays USS a small annual fee to defray the printing and administrative costs of making the program available to their employees. Corporate participants bear no risk of loan defaults and receive no income from the program. Loan applications are examined for conformance to program credit criteria. Loans are disbursed to borrowers meeting the credit criteria by a national bank, as lender of record. Upon disbursement, loans become subject to a surety bond that assures payment of principal and interest, subject to a first loss deductible. Periodically, USS issues commercial paper to fund its acquisition of loan balances from the lender of record for the purpose of permanently financing the loans acquired and to fund a reserve against unreimbursed loan losses. Two series of USS commercial paper issued for this purpose are presently outstanding. Each series is secured by separate letters of credit issued by third-party credit providers. Both are foreign: one Japanese and one Australian.

The need that programs such as ours have to obtain credit from sources other than traditional capital market participants such as banks and insurance companies, is illustrated by our experience in relying upon financial institutions as credit providers. Our rapid growth has been constantly impeded by capacity constraints which affect each of our financing partners. Our initial originating bank was unwilling to originate more than $35,000,000 of loans and its successor, after participating in our program for nine months, reorganized its consumer lending division in a manner which precluded further participation; we are now working with a third originating bank.

Our initial letter of credit bank was unwilling to secure more than $75,000,000 of commercial paper and its successor was unwilling to secure more than $35,000,000; we are presently negotiating with several credit providers in addition to these banks.

Most recently, our surety also indicated that it is facing capacity constraints. I would add that each decision to limit program participation appears to have been part of an overall institutional decision to limit exposure to student loans or to limit financial risk exposure generally. Such limitations upon the exposure of general capital market participants to a single program may be prudent from the point of view of the financial institutions involved. However, in the present environment in which credit availability generally has been severely contracted, the dependence of our program upon financial institutions as credit providers significantly increases costs to borrowers, impedes the availability of loans and may ultimately cause program lending to cease.

I wish to stress that this may occur notwithstanding that the top rated financial institutions that have participated in our program to date have validated our program credit criteria through their participation in the origination of over $185,000,000, and in the permanent financing of over $100,000,000 of loans. These capacity constraints will confront any program which, because of the age of its portfolio and the absence of accumulated reserves or a permanent motivated source of guarantee is dependent upon third-party credit providers at a time when overall credit availability is contracting. Further, these constraints will most severely affect precisely those programs that have the greatest success in addressing borrower need and hence the most rapid increase in their need for access to the capital markets. Program sponsors who, like USS, were established for the purpose of financing education will not willingly follow financial institutions in restricting the availability of loans even to credit-worthy middle income borrowers in response to current economic conditions. Such program sponsors, however, are unlikely to have sufficient financial resources to allow them to establish independent access to the capital markets during the early years of their program.

The House Committee Report on the Higher Education Act of 1965 quoted the then Commissioner of Education as follows:

> "Helping the middle income student and his family to bear the heavy brunt of college costs would seem to have a reasonable claim on a share of our national commitment to offer every child the fullest possible educational opportunity."

The House Committee Report on the Higher Education Amendments of 1986 cited this conclusion and noted that:

> "Far from being a loan of convenience for middle income families, the Guaranteed Student Loan has become a loan of necessity for all families."

Five years later it is clear that much more than a Guaranteed Student Loan is needed by our middle income borrowers. The average amount requested by our borrowers is $7,600 and our average loan is $6,200.

Programs such as ours, which evolve outside of the traditional capital markets and have demonstrated both that they address the needs of credit worthy borrowers for educational loan financing and that their credit criteria constitute an acceptable basis for capital market financing, should be helped to meet the educational loan needs of middle income Americans.

Ideally, funds should be made available to such successful programs through interest-bearing loans from the Federal government or one of its agencies to allow such programs to permanently fund educational loans without reliance upon the capital markets. Alternatively, assistance in establishing program credit might be made available by the Federal government or one of its agencies either: (i) through a guarantee loan repayment; or (ii) through grants or non-interest-bearing loans to fund sufficient reserves to allow these successful programs to finance in the capital markets without reliance upon third party credit providers such as student loan sureties and letter of credit banks.

We project our own need for permanent financing in the present calendar year to be a minimum of $250 million and expect this need to increase to $700 million in calendar year 1995.

Such assistance could be provided either by the Department of Education or by Sallie Mae. The Omnibus Budget Reconciliation Act of 1981 authorized Sallie Mae to exercise its powers to make warehousing loans and to act as a secondary market with respect to non-insured loans and to:

> "Undertake any other activity which the Board of Directors of the Association determines to be in furtherance of the programs of insured student loans...or will otherwise support the credit needs of students."

The Higher Education Amendments of 1986 contained a provision intended to clarify the intent of Congress that:

> "...in carrying out all such activities the purpose shall always be to provide secondary market and other support for lending programs offered by other organizations and not to replace or compete with such other organizations."

The House Conference Report on this legislation commented that this statement of Congressional intent was to assure that, in carrying out its activities under the authority granted in 1981, Sallie Mae would:

> "...be mindful of the need to support lending programs offered by others. Sallie Mae's objective should not be simply to substitute its programs for effective programs developed by others. Instead, Sallie Mae should identify education credit needs that have not been fully met by others, and design programs to meet those needs."

Further legislative clarification is needed to require that the credit needs of students be supported through the priority provision of Sallie Mae, i.e. to provide funding to successful middle income educational loan programs such as ours. This is consistent with the Congressional intent of permanently financing educational loans or for the purpose of establishing reserves and would provide a feasible legislative basis for Sallie Mae to support us in continuing to meet the full need for educational loans now being faced by credit worthy middle income Americans.

Thank you.

Mr. ANDREWS. Father, thank you very much. We are next going to hear from Thomas A. Butts who is Associate Vice President for Government Relations at the University of Michigan in Ann Arbor, Michigan. Welcome, Mr. Butts.

Mr. BUTTS. Thank you, Mr. Chairman and members of the subcommittee. I am Tom Butts, Associate Vice President for Government Relations at the University of Michigan. I am pleased to appear before you today on behalf of the National Association of State Universities and Land Grant Colleges to discuss the possibility of a major improvement in the student assistance programs through direct Federal lending.

I will summarize my statement, which I understand will be included in full in the record.

The American Council on Education and 12 other higher education associations, including NASULGC, submitted a direct lending proposal to you on April 8, 1991. The Land Grant Executive Committee has asked its members to explore further the feasibility of substituting direct loans for the Stafford part of the Guaranteed Student Loan Program.

Indications are that this is possible. Well, my statement focuses on direct lending. NASULGC is concerned, along with the entire education community, about the grant-loan imbalance which has developed over the past 10 years. Credit reform and this reauthorization of the Higher Education Act provides a rare opportunity for the Congress to consider a serious restructuring of the student loan programs and make significant improvements in student credit by authorizing a program of direct loans.

According to the 1989 CBO study on credit reform, the total cost to the government of new guaranteed loans is now many times more than the cost of new direct loans. Credit reform has made direct loans a less costly and much simpler way to deliver loan assistance to students. Savings in the first year alone have been estimated by some to be greater than $1 billion.

Mr. Chairman, I believe the documentation that you requested from the Education Department on April 25, 1991, when it is supplied to you, will substantiate significant savings, savings which should be directed to students.

The Federal Government presently obtains capital for the GSL program by paying retail price incentives to the capital markets. Under credit reform it can now obtain capital wholesale from private markets for student loans.

Prior to credit reform and in the competition for limited grant dollars, the Perkins Loan Program was never able to receive full funding. In fact, it is over $8 billion short the amount of lending under the Stafford program.

As a matter of Federal policy the Stafford part of the GSL program has evolved and shifted from being the major program of support for middle income students to being the primary loan program for students with demonstrated financial need.

Direct lending makes it possible to have one need based loan program for students, finally accomplishing the funding goal of the Perkins program. To be supported by the education community, direct loans must be entitlements as is the current GSL program.

Similarly, the amount of capital available under a direct program must be limited only by student eligibility, not by a fixed amount or cap per year. In this respect it would be identical to the existing GSL program.

The recent report of the Senate Permanent Subcommittee on Investigations calls for the Congress top, "undertake major and in some areas drastic reform of the GSL program." The GAO is called upon to study the feasibility of alternative approaches, quote, "including abolishing the guarantee agency concept."

The GSL program is an immensely complicated and expensive program for students, schools, and the department and the Congress. By contrast, the school can process and deliver a Perkins loan along with a student's regular application for grants and scholarships. The paper work necessary for a Perkins loan is substantially less than that of a Stafford loan.

Direct loans can provide a number of advantages to students, including elimination of up front origination and insurance fees, elimination of the GSL application, timely delivery of aid, more student counseling time available for it by financial aid officers, improved access to deferments, automatic loan consolidation and choice of repayment plans.

On the collection end there is no doubt about who owns the loan. It is the Federal Government. The program would operate using aspects of several student aid programs that have worked well in the past and are described in full in my statement. The Secretary of the Treasury would obtain capital for direct loans through the sale of government securities by the Federal Financing Bank the same way funding was provided for Sallie Mae until 1981.

Treasury would make funds available to the Secretary of Allocation for allocation to institutions through the Education Department's finance system, from which institutions presently draw student aid funds. It is important to note that all of the finance matters pertaining to the capital would be handled by Treasury.

For direct loans the Education Department would no longer be expected to have expertise in finance, loan guarantees, secondary markets. The Education Department would have responsibility for servicing and collection. The department would have contracts, including performance bonuses, with private sector servicers, for billing, collections, and a national data file.

Since most of the administrative activity would be done under contract, the department's principal responsibility would be oversight. We recommend strongly that the Congress set aside salary and expense money for the operation of all Title IV student assistance programs, including direct loans.

Since a direct loan program would not have the complexities of lenders, secondary markets, and guarantors, it clearly would be easier for the department to manage than Stafford loans. All of this comes at a time when Secretary of Education Lamar Alexander has announced his initiative to make major management improvements in the student aid programs.

This is encouraging because with good leadership and reasonable resources, public servants can manage programs very well. Of course, direct lending should be implemented only after adequate lead time has been provided for detailed planning and preparation.

Mr. Chairman, thank you for your time and consideration of these ideas. I hope the subcommittee will take advantage of this opportunity to improve the student aid programs, and I would, of course, be happy to answer any questions you might have.

[The prepared statement of Thomas A. Butts follows:]

STATEMENT OF

THOMAS A. BUTTS

UNIVERSITY OF MICHIGAN

ON BEHALF OF

THE NATIONAL ASSOCIATION OF STATE UMIVERSITIES
AND
LAND GRANT COLLEGES

REGARDING DIRECT LOANS FOR STUDENTS

BEFORE

THE SUBCOMMITTEE ON POSTSECONDARY EDUCATION
EDUCATION AND LABOR COMMITTEE

JUNE 12, 1991

Mr. Chairman and Members of the Subcommittee, I am Thomas A. Butts, Associate Vice President for Government Relations at the University of Michigan. I am pleased to appear before you today on behalf of the National Association of State Universities and Land Grant Colleges (NASULGC) to discuss the possibility of a major improvement in the student assistance programs through direct Federal loans.

By way of background, I was the Director of Student Financial Aid at the University of Michigan from 1971 to 1977. From 1977-1981, I was on leave from the University and served with the U.S. Department of Education as a policy advisor for student assistance and later as the Deputy Assistant Secretary for Student Assistance. I have continued since then to be involved in student aid policy issues.

Mr. Chairman, the American Council on Education (ACE) and twelve other higher education associations, including NASULGC, submitted a direct lending proposal to you on April 8, 1991. The bill language submitted at that time would, in substance, implement the proposal which I will describe in more detail today. The NASULGC Executive Committee has asked that its Legislative Committee explore further the feasibility of Federal direct lending, including substituting direct loans for the Stafford part of the Guaranteed Student Loan Program (GSL). Indications are that this is possible. This statement is, in part, an update to an April 30, 1991, NASULGC paper regarding direct lending.

Credit reform, Mr. Chairman, and this reauthorization of the Higher Education Act provides a rare opportunity for you to consider a serious restructuring of the student loan programs and make significant improvements by authorizing a program of direct loans. The credit reform provisions of the Budget Reconciliation Act of 1990 made significant changes in the way the government accounts for the credit it extends in the form of loan guarantees and direct loans.

According to the December 1989, Congressional Budget Office study on credit reform,

> The difference in the budgetary treatment between direct loans and guaranteed loans creates a bias in favor of guarantees because their costs are deferred. When the costs are known (after default) and finally recorded in the budget, they are well past the government's control. Consequently, loan guarantees have been growing much faster than direct loans in recent years. **The total cost to the government of the new guaranteed loans is now many times more than the cost of new direct loans.** (p. xii - emphasis added)

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The President's FY 92 Budget states that:

> Clearly, credit reform is not "just" an accounting change. It is an opportunity to see each program with fresh eyes. Credit reform asks the right questions: Who is being helped? By how much? At what cost? It focuses attention and budgetary decisions on the costs underlying each loan, juxtaposed with the borrowers who benefit from these programs. It provides perspective for both policy analysis and program management. (Part Two - 226)

What are the implications of credit reform for student loans?

The Federal government presently obtains capital for the GSL program by paying **retail** price incentives to the capital markets. Under credit reform, it can obtain capital **wholesale** from the same (and other) private capital markets. This reduces significantly costs to the taxpayers.

Prior to credit reform, the entire amount of the capital used for direct loans appeared as a Federal cost. Only government subsidies were included in the Federal budget for guaranteed loans - not the loan capital. This apple and orange situation caused direct loans to appear more costly than guaranteed loans.

Under credit reform, both types of loans are priced the same way. Only the costs associated with obtaining the capital and subsidies are counted in the budget - not the amount of capital involved. In the case of GSLs, the government obtains capital from private capital markets through guarantees and special allowance incentives (Lenders are entitled to the average of 91 day Treasury Bills plus 3.25% with no cap). In the case of direct loans the government acquires capital from private capital markets through the sale of government securities (treasury bills, etc.).

With credit reform, the cost to the Treasury of a cohort of GSL or direct loans made each year is scored in the budget for the projected life of the loans. Included are costs paid by the government for defaults and the cost of capital such as special incentive allowances to lenders (for GSL) or the cost of Treasury securities (for direct loans). Federal administrative costs are accounted for as a line item in the mandatory part of the budget.

An examination of the cost of a direct student loan and a loan guarantee, all factors like student interest rate being held equal, will show that a direct loan will be less costly to the government than a GSL - primarily because the government can borrow money from the private sector at Treasury bill rates for direct loans rather than the 91 day Treasury bill rate plus 3.25% now assured to GSL lenders, even during the in-school period.

Under credit reform, government **borrowing** from the private sector **for direct loans does not increase the deficit. The payment of higher GSL subsidies does increase the deficit.** In addition, direct borrowing for student loans would replace existing guaranteed borrowing. Also, over time the flow of repayments back to the capital markets would approximate the amount borrowed for new loans - thus establishing something akin to a national revolving fund.

Would a direct loan program be an entitlement?

For a direct loan program to be supported by the education community, it **must be an entitlement** (mandatory) program as is the current GSL program. Similarly, the **amount** of capital available under a direct program must be **limited by student eligibility** - not by a fixed total amount or cap per year. In this respect, it would be identical to the existing GSL program except that capital availability would not be dependent on lender willingness to loan.

Why restructure the student loan programs?

Credit reform has made direct loans a less costly way to deliver loan assistance to students. Savings in the first year alone have been estimated to be greater than one billion dollars. Mr. Chairman, I believe that the documentation that you requested from the the Education Department (ED) on April 25, 1991 (when supplied to you) will substantiate the savings - savings which should be directed to students.

The recent report of the Senate Permanent Subcommittee on Investigations, chaired by Senator Sam Nunn (D-GA), documented many of the costs and problems associated with the GSL program. Among them are: the rate of student defaults, the financial failure of one major guarantee agency, questions about the strength and number of guarantee agencies, severe problems in managing student loans by lenders, and fraud and abuse by certain lenders and some trade schools. The General Accounting Office (GAO) recently reported that the GSL program has become such a maze that it cannot be audited.

The Nunn report calls for the Congress to "...undertake major and, in some areas, drastic reform..." of the GSL program. (p.34) The GAO is called upon to study the feasibility of alternative approaches including "...abolishing the guaranty agency concept." (p. 39)

The GSL Program is an immensely complicated and expensive program for students, schools and the ED. With more than 13,000 lenders, over 50 guarantee agencies and several secondary markets participating in this error prone program, the bewildering array of paperwork, regulations, procedures and fees is enormous. Many colleges and universities deal with every guarantee agency during the course of the year and with hundreds of lenders. Notwithstanding efforts by some guarantors and lenders to streamline the GSL program, it takes unnecessary time within the institution, plus the time required by guarantors and lenders, to process GSLs. Despite empty promises made by guarantee agencies for more than 15 years, institutions are still subjected to different policies, forms and computer formats by each agency.

By contrast, a school can process and deliver a Perkins Loan along with a student's regular application for grants and scholarships. **This significantly reduces the amount of paperwork**. A direct loan would be originated much like a Perkins loan. The institution has direct control over the timing and distribution of loan funds. This control would enable the institution to assist students better and improve institutional cash flow.

Direct loans can provide a number of **advantages to students** including the elimination of the GSL application, timely delivery of aid, more student counseling by financial aid officers, elimination of up front origination and insurance fees, improved access to deferments, automatic loan consolidation, choice of repayment plans with no additional charges, and reduction in the constant pressure to increase student interest rates to offset government subsidies. Further, students experiencing hardships or changes in financial circumstances requiring an adjustment in the amount of their loans will be able to have their requests dealt with promptly. On the collection end, students will know who "owns" their loan - the government. In addition, student horror stories which abound about the paperwork obstacles to higher education caused by both obtaining and repaying GSLs would be vastly reduced and be no greater than those experienced with the grant delivery system which is expected to be simplified by the Congress as part of reauthorization. Given the recent flexibility to schools to determine loan amounts in the GSL program, "red-lining" should be prohibited.

As a matter of Federal policy, the GSL program has evolved and shifted from being the major program of support for middle income students to the primary loan program for students with demonstrated financial need. When the GSL program was created in 1965 (modeled after several existing State guarantee programs), it was intended to provide loans to students from middle income families. Since low income students were served by the Perkins program, there was little necessity for these students to obtain GSLs. In the absence of credit reform, this change in focus resulted from the inability of the Congress to appropriate adequate loan capital for the Perkins program and still maintain support for the grant programs. There is no point in having two Federal student loan programs with the same financial needs test if there is adequate capital available to meet all student need remaining after grants have been awarded.

The GSL program, however, is now asked to provide three types of loans - Stafford loans for students who demonstrate financial need, Parent Loans for Undergraduate Students (PLUS), and Supplemental Loans for Students (SLS) who do not qualify for Perkins or Stafford loans or who need more money than they are able to qualify for under other student assistance programs.

Experience with the Perkins program shows that operationally direct loans serve both students and most institutions better than Stafford loans. Under a direct loan, origination is simple and the student knows who made the loan.

How would the government obtain capital for direct loans?

The Secretary of the Treasury, in consultation with the Secretary of Education, would sell treasury securities to the private capital markets in accordance with its usual practice to obtain necessary capital. This would be accomplished in the same way funding for Sallie Mae was provided until 1981.

Under that procedure, the Secretary of the Treasury, through the Federal Financing Bank, sold government securities to the private sector at the appropriate time and made the funds available to Sallie Mae. That system worked nicely, and Sallie Mae is making payments on about $4.8 billion it still holds. In the case of direct loans, the Secretary of the Treasury would make funds available to the Secretary of Education for allocation to institutions through the ED finance system from which institutions presently draw student aid funds.

It is important to note that all of the "finance" matters pertaining to the capital would be handled by Treasury. For direct loans, ED would no longer be expected to have expertise in finance, lending, loan guarantees or secondary markets. Repayments would return to the private markets through the Treasury and not be left to accumulate in institutional revolving funds as is the case with Perkins loans. Allowing collections to remain in institutional revolving funds would cause the proposed program to lose its status as an entitlement or mandatory program. Perkins loans are scored in the budget as discretionary grants to institutions because the loans become part of revolving funds at the institutional level. The concept of "insurance" does not apply in the case of a direct loan since the government already owns the loan note.

How would a direct loan program operate?

A new direct loan program would be similar in concept to the Pell Grant Program, i.e., institutions are essentially agents of the federal government and process the loan on the government's behalf. The Pell Grant Program is not technically a campus based program. Students receive vouchers (Student Aid Reports) that they may use at any eligible institution.

While a student voucher would not be involved, a direct loan program would operate in a similar way in that the loan is made directly by the federal government to the student with the institution acting as the originator.

How would funds be allocated to institutions?

The allocation of funds to institutions could take place following one or a combination of existing models. A preferred approach would be to use the distribution system utilized for Perkins loans and the other campus based student aid programs. Under this method, the Fiscal Operations Report and Application (FISAP) would be used to make initial allocations each year. Institutions would indicate on the FISAP the amount lent in the previous year and project needs for the coming year. Institutions not participating in the campus-based programs would only complete the direct loan section. The ED would approve all initial requests, unless it had reason to believe the request was not reasonable or the school was not eligible. Another approach would be to use the Pell Grant allocation system. In either case, the reconciliation of individual student records would NOT take place at this point in the process. Special adjustment requests would be made during the course of the year by institutions to increase or decrease their allocations in accordance with actual student eligibility for direct loans. Reconciliation of individual student accounts would occur at the end of the year with the filing of the FISAP report.

Under either approach, institutions would follow existing ED procedures to draw necessary funds on a timely basis to fund all eligible students. These procedures do not allow institutions to obtain funds more than three days in advance of the time they are to be expended.

How would student eligibility be determined?

Following current practice, students would apply for all forms of financial aid and provide need analysis information to the institution(s) they attend or plan to attend.

Institutions would conduct a need analysis, determine eligibility, package direct loans with other student aid and notify the student of award amounts and conditions.

How would the loan be disbursed to the student?

Like the Perkins loan program, institutions would prepare a promissory note for the student's signature. Following appropriate loan counseling procedures, the student would sign the promissory note. Funds would then be credited to the student's institutional account or given to the student depending on the circumstances. For those institutions who do not participate in the Perkins program, the signed promissory note would be similar in concept to the Student Aid Report necessary to make payments to students.

What would happen after the loan is disbursed?

The Federal Government (Education Department) would have responsibility for servicing and collection. ED would have contracts (including performance bonuses) with private sector servicers for billing and collection. Institutions who so desired and were qualified might act as servicers for their students.

Institutions would deliver signed promissory notes to an ED contractor. It is expected that arrangements would be made for several means of delivery, including possible electronic transfer of notes.

Would there be a national data base with direct student loan information?

Yes. Multiple year notes and notes from different schools would be consolidated immediately under this system. With the opportunity to establish a new central file, the insurmountable data problems of the existing GSL program would be phased out. The Pell Grant Program has demonstrated that a central processor can work with multiple data entry contractors. In this case, loan servicers would relate to a central processor in a similar manner. Servicers would be required to meet uniform ED specifications and would be subject to audits and reviews by ED.

Institutions would continue to report enrollment status as they do now in the GSL program - only with one uniform reporting system synchronized with institutional academic calendars.

Since most of the administrative activity would be done under contract, the Department's principal responsibility would be oversight. Other government agencies, such as Treasury, might assist with management of the collection responsibility.

What about administrative support/capability in the Education Department?

While ED has experience in working with private sector servicers and has a credible record in collections, the Congress must set aside salary and expense money for the operation of all of the Title IV student aid programs, including direct loans. Funding should be directed by the Congress for training, technical assistance to institutions, program reviews, contracts, and contract administration. Additionally, Congress should provide initial funding to ED to enable it to obtain and utilize state of the art telecommunications and computer technology to handle loan transactions and management information. This is one of the most important recommendations made by ACE and other higher education associations to the Congress.

The GSL program has been patched together over the years to the point where it cannot be audited or managed effectively. Under difficult circumstances over the past ten years, ED has done a credible job of administering the Pell Grant and campus based student aid programs. In addition, it has managed Perkins and GSL default collections activity well under these conditions. Indeed, as the Nunn hearings have demonstrated, there is serious question about the quality of some of the servicing done by private lenders in the GSL program. The ED system makes use of private servicers and loan collection contractors in addition to the IRS offset program. ED has also managed large elementary and secondary education programs well.

Since a direct loan program would not have the complexities of lenders, secondary markets and guarantors, it would clearly be easier for the ED to manage than Stafford loans. All financing matters would be handled by the Secretary of the Treasury. ED would handle the delivery and oversight of institutions and collection/servicing contractors. For direct loans, it would no longer be necessary for ED to monitor 13,000 lenders, over 50 guarantee agencies and the participating secondary markets. This should enable ED to avoid over regulation and micro management of the program.

Direct loans would operate more like Perkins loans and would not at all be similar to the Federally Insured Student Loan (FISL) program which was a guarantee type program abused by some institutions and lenders and lacked administrative support within ED. Correspondence schools, for example, no longer participate in GSL. They were major participants in the FISL program and a source of many problems.

All of this comes at a time when Secretary of Education Lamar Alexander has announced his initiative to make major management improvements in the student aid programs. This is encouraging because with good leadership and reasonable resources, public servants can manage programs very well.

Which institutions could participate in direct loans?

The Congress must determine institutional eligibility. Clearly, eligible institutions should be able to demonstrate administrative capacity to meet their responsibilities for fiscal stewardship and management for direct loans or any Federal student aid program. Apart from direct loan responsibility, recent changes in law have eliminated many questionable institutions from the student aid programs. In addition, proposed reauthorization changes in accreditation and licensure by the education community and the Administration would further tighten the system. Finally, with clear lines of responsibility and accountability in a direct loan program, the opportunities for mischief with the taxpayers' money which exist in the GSL program should be reduced significantly.

Would institutions be provided administrative allowances?

It is essential that institutions be provided adequate administrative support. To begin a new program with the promise of eliminating the problems of the existing GSL program without providing good administrative support up front would not be wise. Institutions may find that the administrative savings they achieve from the elimination of all or a part of the existing GSL program will help offset some new costs. The issue must be examined and appropriate administrative allowances and support provided. The ACE proposal suggests an annual $20 allowance per eligible direct loan student.

It should be noted that guarantee agencies now receive one percent as an administrative cost allowance (about $110 million yearly) from government appropriations. Also they have the use of student financed insurance premiums of up to three percent. Agencies also retain 30 percent of collections they make on defaulted loans.

What about small schools or schools that do not presently participate in the Perkins program?

The ED could arrange a contract for an alternative administrative entity which would assist schools that do not wish to administer the loan program themselves or lack the administrative capability necessary to manage it. This alternative system would be similar in concept to the "alternative disbursement system" for Pell Grants which existed prior to 1981.

However, many small schools may find that a direct loan program would be easier to manage than the existing Stafford program. This would be due to the fact that the lender and guarantee activity is removed, time delays to the student eliminated, and cash flow to the institution improved.

What about institutional liability?

Institutions are presently liable for errors made in executing any of the tasks they perform related to the GSL program; this would not change with direct loans. The institution would need to draw down funds, determine student eligibility, and disburse funds correctly. Once promissory notes have been accepted by the government (within a proposed 45 day statutory time limit) liability would end (except, of course in cases of fraud). Institutional liability would be less than GSL since the number of entities dealt with would be reduced and the institution would have control over the entire origination process. In addition, the institution would still have access to the student's account to recover funds and the opportunity to find the student to obtain a missed signature on a promissory note.

What about institutional cash flow?

Most institutions would have an improved cash flow under a system of direct loans. Not only would funds be available when school started, the delays caused by handling checks co-payable to the institution and the student from hundreds of lenders would be eliminated. Of course, institutions would be required to follow existing cash draw procedures which prohibit funds from being on hand more than three days prior to disbursement and from earning "float" while in an institutional account.

Could the financial aid transcript be eliminated?

Currently, notification of a student's federal aid must be made to the institution to which a student transfers. This is accomplished through a cumbersome and expensive financial aid transcript process. With a a national direct loan data file on all students and the existing Pell grant data file, it would be possible to eliminate the financial aid transcript - a major paperwork problem for institutions.

What would happen to the existing Perkins loan revolving funds located at institutions?

Ongoing collections from existing Perkins loans which return to institutional revolving funds should be left at the institutions, invested in new Perkins institutional endowment accounts, and the income used for other student aid purposes or special student loans. Under this approach, collections would be invested in an institutional endowment or total return fund for that purpose and the earnings used for student grants or employment. Over the years, many schools could get out of the loan collection business!

What role might exist for guarantee agencies or lenders?

The parent loan program (PLUS) should be significantly improved as a guaranteed loan for dependent (middle income) students.

The maximum PLUS loan should be determined by the cost of education less other financial aid received by the student as recommended by ACE and other higher education associations. In addition, the tax writing committees should be encouraged to restore the interest deduction for parent and student loans as part of an overall plan to help parents of dependent students.

While all three GSL programs - Stafford, PLUS and SLS - could be operated under a direct system, it could be argued that the low cost of the unsubsidized PLUS and SLS programs together with the more natural relationship between credit worthy parents and lenders makes policy sense to continue these programs. Guarantee agencies may also wish to participate in the servicing function for direct loans.

How should direct loans be phased in?

ACE and twelve other higher education associations have proposed that need based direct loans be available to institutions on an optional basis. Under this proposal, an institution would participate in either Stafford or direct lending. Another option is to substitute direct lending for the Stafford and Perkins programs, bringing all new need based lending under one program. Proposed legislation sent to the House Subcommittee on Postsecondary Education on April 8, 1991, by ACE provides legislative language consistent with the framework for direct loans described in this paper.

For students who have both Stafford and direct loans, direct loans might be made eligible for inclusion in the existing loan consolidation program. The existing Stafford portfolio will, of course, have to be phased out and provisions for transition made if the bolder option is adopted. It might be necessary, for example, to change the existing administrative cost allowance (ACA) of one percent of new loans originated to an allowance based on outstanding loans. In addition, increased PLUS volume might replace a substantial portion of ACA lost due to the elimination of the Stafford loan volume.

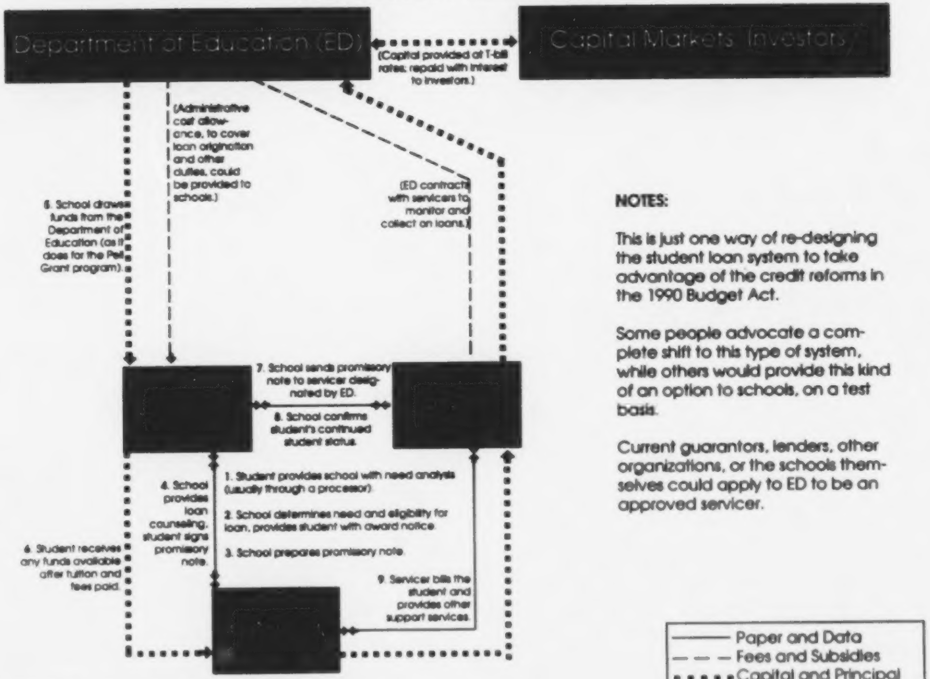
When should direct lending be implemented?

Direct lending should be implemented only after adequate lead time has been provided for detailed planing and preparation. At a minimum that should be one full program (school) year following the date of enactment. For example, if the President signed the enabling legislation in March of 1992, the program should not go into effect until July 1, 1994.

The development of a direct loan plan is a dynamic process that will continue to require the best thinking of many people. The advantages and disadvantages of changing a major student aid program will have to be carefully considered.

Mr. Chairman, thank your for your time and consideration of these ideas. I hope the Subcommittee will take advantage of this opportunity to improve student aid programs. I would be happy to answer any questions you might have.

"Direct Loans": An Example



(Capital provided at T-bill rates; repaid with interest to investors.)

(Administrative cost allowance, to cover loan origination and other duties, could be provided to schools.)

(ED contracts with servicers to monitor and collect on loans.)

5. School draws funds from the Department of Education (as it does for the Pell Grant program).

7. School sends promissory note to servicer designated by ED.

8. School confirms student's continued student status.

1. Student provides school with need analysis (usually through a processor).

2. School determines need and eligibility for loan, provides student with award notice.

3. School prepares promissory note.

4. School provides loan counseling, student signs promissory note.

6. Student receives any funds available after tuition and fees paid.

9. Servicer bills the student and provides other support services.

4/29/91 Prepared for discussion purposes by the Office of Senator Paul Simon

NOTES:

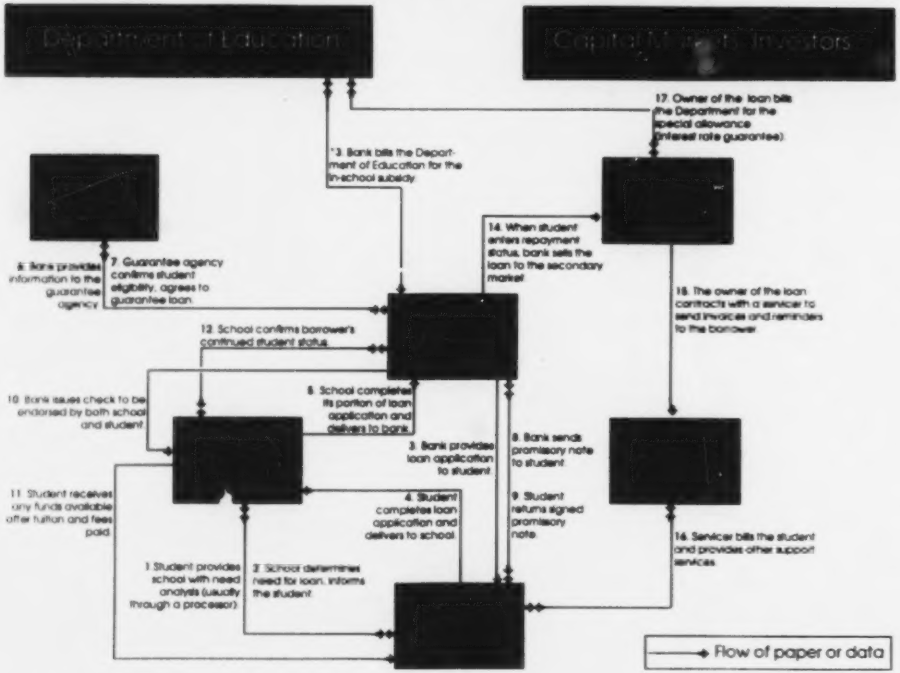
This is just one way of re-designing the student loan system to take advantage of the credit reforms in the 1990 Budget Act.

Some people advocate a complete shift to this type of system, while others would provide this kind of an option to schools, on a test basis.

Current guarantors, lenders, other organizations, or the schools themselves could apply to ED to be an approved servicer.

——— Paper and Data
— — — Fees and Subsidies
• • • • • Capital and Principal

Stafford Loans: The Paper Trail (one version)


Department of Education
Capital Markets Investors
17. Owner of the loan bills the Department for the special allowance (interest rate guarantee)
13. Bank bills the Department of Education for the in-school subsidy
14. When student enters repayment status, bank sells the loan to the secondary market
6. Bank provides information to the guarantee agency
7. Guarantee agency confirms student eligibility, agrees to guarantee loan.
15. The owner of the loan contracts with a servicer to send invoices and reminders to the borrower
12. School confirms borrower's continued student status
10. Bank issues check to be endorsed by both school and student.
5. School completes its portion of loan application and delivers to bank.
3. Bank provides loan application to student.
8. Bank sends promissory note to student
9. Student returns signed promissory note
11. Student receives any funds available after tuition and fees paid.
4. Student completes loan application and delivers to school.
16. Servicer bills the student and provides other support services.
1 Student provides school with need analysis (usually through a processor)
2. School determines need for loan, informs the student
Flow of paper or data

4/4/91 Office of Senator Paul Simon

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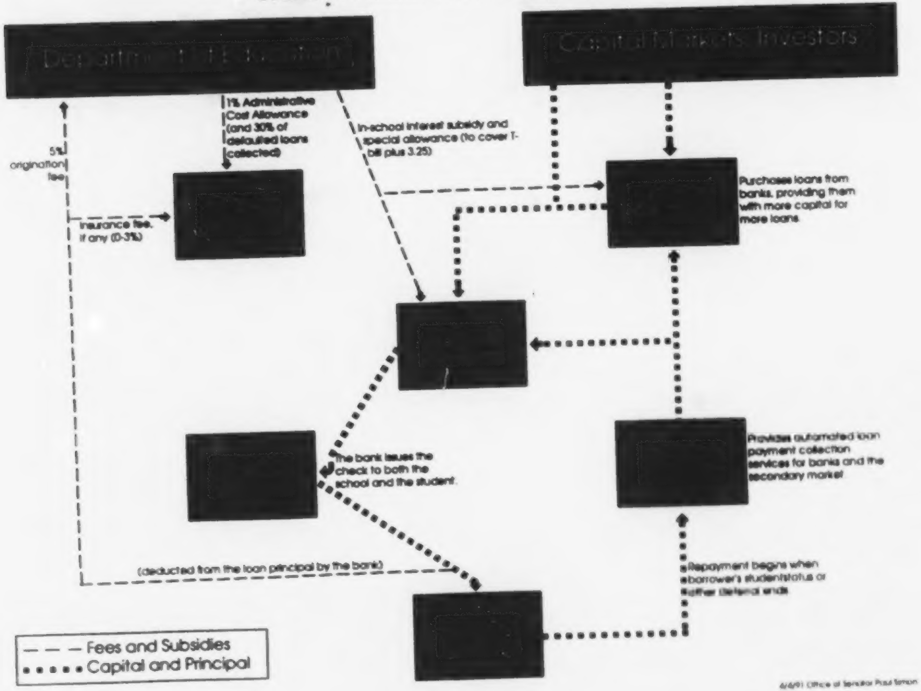
Stafford Loans: The Money Cycle


Department of Education
Capital Markets Investors
5% origination fee
1% Administrative Cost Allowance (and 30% of defaulted loans collected)
In-school interest subsidy and special allowance (to cover T-bill plus 3.25)
Insurance fee, if any (0-3%)
Purchases loans from banks, providing them with more capital for more loans
The bank issues the check to both the school and the student.
Provides automated loan payment collection services for banks and the secondary market
(deducted from the loan principal by the bank)
Repayment begins when borrower's studentstatus or other deferral ends
— — — Fees and Subsidies
• • • • • Capital and Principal

6/6/91 Office of Senator Paul Simon

Mr. **Andrews**. Thank you very much, Mr. Butts.

We are next going to hear from Mr. Joe Belew who is President of the Consumer Bankers Association in Arlington, Virginia. Did I pronounce your name correctly, Mr. Belew?

Mr. **Belew**. Yes, you did. You are one of the few.

Mr. **Andrews**. Welcome, and we look forward to your statement.

Mr. **Belew**. Thank you. Mr. Chairman and members of the subcommittee, I am Joe Belew, President of the Consumer Bankers Association, and we are pleased to offer our views today on various alternatives to the Stafford Loan Program, and in particular the direct lending alternatives which were previously discussed.

We will not surprise you today. Lenders do not believe radical change in the structure of the GSL program is necessary. In our view, the programs are working relatively well. Since 1965 I don't need to tell the subcommittee, more than $114 billion in private capital has been provided to more than 53 million students.

In fiscal 1990 alone eligible lenders made more than $12 billion in insured loans available to over four and a half million student borrowers. By acknowledging these successes we are not overlooking the significant problems which have been discussed extensively before the subcommittee.

As I hope you are aware, CBA's lenders support the reform efforts undertaken by Congress and the department in the last 5 years, but today I am placed in the difficult position of defending the existing student loan program against the promises of an alternative which has not yet been created or tested by real world challenges. The arguments in support of discarding the current program need to be viewed in that context.

The written testimony today focuses on three major areas: our conclusions regarding direct lending alternatives following review of several proposals before the subcommittee; secondly, CBA's assumptions about why some institutions have expressed support for direct lending alternative; and third, some specific concerns that the subcommittee should address and any review of the proposals on your part.

We have six of these concerns, and I would say this is the heart of our testimony. First, the impact of direct lending on the existing GSL program structure. Second, the anticipated loss of program accountability. Third, the potentially increased default costs for the Federal Government. Fourth, the problems posed by a transition to direct lending. Fifth, the risk of losing loan access for low income students; and sixth, the uncertainty about the long term availability of Federal capital.

Let me begin with our general comments on several direct lending alternatives. All the proposals are drafted to take advantage of the recently enacted Credit Reform Act. This legislation would allow OMB to raise the necessary capital for student loans as an off-budget item and appropriate only the actual cost, that is, subsidies, default payments, and administrative charges. Because Federal funds borrowings are less expensive than private sector borrowings, this is portrayed as an overall Federal savings for the program.

All of the proposals also suggest that a party other than the Department of Education act as a servicer of these loans. There seems to be agreement that asking the department to directly assume the task of servicing is unrealistic.

Finally, all of the proposals eliminate the need for a Federal guarantee. The Federal Government would, instead, absorb the full amount of any default or require the loan servicer or some other party to absorb part or all of the default costs.

CBA believes there are several reasons why schools support direct loans. For one, schools do not like dealing with multiple guarantee agencies and lenders. Also, schools do not like numerous default reduction provisions enacted over the last 5 years such as delayed disbursement, multiple disbursement, entrance and exit counseling, and mandatory pro rata refund policies. Low default institutions, in particular, resent this Federal intrusion, and as well, some institutions believe enactment of direct loans would result in a dramatic increase in Pell grant funding.

Let me add an aside at that point. Enactment of a $4,000 maximum Pell grant, without the modifications supported by the administration, would require an annual appropriation of between $8 billion and $10 billion. This represents a dramatic increase over current Pell funding that far exceeds anticipated savings from any direct lending program.

There are several major concerns CBA believes should be considered in evaluating any direct loan proposal. First, the existing GSL program structure would probably be destroyed. Once the flow of new loans and guarantees into the portfolio of guarantors and lenders ceases or is substantially reduced, virtually all lenders will initiate phase-out of their participation in the program.

Many guarantors, faced with insolvency, will do the same. Twenty-five years of technical expertise will be lost. Those familiar with the history of the Guaranteed Student Loan Program know that persuading lenders to make loans to students with no income and no previous credit history was not easy. Once the current program is phased out, securing private sector participation if the need arises in the future will be difficult.

The second major concern, program accountability. In existing GSL program both lenders and guarantors face financial exposure if program operations break down. In a direct lending program all default costs will be the responsibility of the Federal Government. If a loan servicer is asked to share in the risk of a default, as has been proposed by some advocates, the cost of absorbing this risk will be passed back to the government in the form of a higher contract fee.

The number three concern was transition problems. They could be very significant. As the Nunn report and the OMB/ED study made clear, management of the GSL program by the department is in urgent need of reform, but to confuse this task by creating yet another loan program would add tremendously to that administrative burden.

Currently, outstanding GSL's have 20 or more years to run before the last payment is received from borrowers. Our lenders, frankly, question the feasibility of relying on the department to operate both programs simultaneously.

Fourth, financial problems could be precipitated among the guarantee agencies. The department has periodically suggested that as many as half a dozen guarantee agencies may face financial difficulty. We suggest that perhaps as many as two dozen of these agencies could face financial difficulty if the GSL program were brought to an end.

I would like to emphasize that protecting guarantee agencies is not a proper reason for supporting the current GSL program. However, a fair review of the direct lending alternative must take into account the risks and the costs associated with phasing out the existing program.

Fifth, low income students, especially those attending community colleges and proprietary schools, are likely to be poorly served under the new program. While some schools are unhappy with lenders and guarantors who have made it difficult for students attending high default rate schools to obtain loans, the net result has been to reduce the cost of the current program.

The fact of the matter is that institutional participation in direct loans is likely to be controlled much more stringently than is the case under current program. If it isn't, this subcommittee should be prepared for a higher level of defaults to occur.

Finally, long term Federal support for direct loans is far from certain. Because of the large capital requirements inherent in direct loans, between $12 to $16 billion per year would have to be provided for direct loans.

We wonder how likely is it that Federal support for the program will be maintained at this level. Over a 10 year period $120 billion to $150 billion would be outstanding, with default losses of at least $10 billion projected.

In closing, Mr. Chairman, we at CBA believe that Congress should be fixing the current GSL program, not creating a new program. On behalf of our member institutions I would like to reiterate our belief that the structure of the GSL program is essentially sound, even with its warts.

Lenders appreciate the opportunity to participate in the program, and we hope Congress will continue to provide us with that opportunity.

The Stafford Loan Program has operated successfully for over 25 years. Lenders endorse the notion that changes are needed to better serve program beneficiaries, and in moving into the mid 1990s we hope the successful public-private partnership which is the hallmark of the Stafford program will be continued.

Thank you, and I will take questions at the end of the other presentation.

[The prepared statement of Joe Belew follows:]

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CONSUMER BANKERS ASSOCIATION *The Association for Retail Banks and Thrift Institutions*
1000 Wilson Boulevard, 30th Floor, Arlington, Virginia 22209-3908 Tel.: 703/276-1750 • Fax: 703/528-1290

STATEMENT OF

JOE BELEW

CONSUMER BANKERS ASSOCIATION

BEFORE THE

HOUSE SUBCOMMITTEE ON POSTSECONDARY EDUCATION

June 12, 1991

Mr. Chairman, Members of the Subcommittee on Postsecondary Education, I am Joe Belew, President of the Consumer Bankers Association.[1] I am pleased to be with you today to discuss the alternatives to the current structure of the Guaranteed Student Loan Programs.

I will surprise no one on this Subcommittee by informing you that lenders do not believe a radical change in the structure of the GSL program is necessary. In my view, the current programs are working well. Since 1965, more than $114 billion in private capital has been provided to more than 53 million students. In Fiscal Year 1990 alone, eligible lenders made more than $12 billion in insured loans available to over 4.5 million student borrowers.

By acknowledging our successes, I am not overlooking the significant problems which have been discussed extensively before this Subcommittee, the Senate Education and Labor Committee, and the Senate Permanent Subcommittee on Investigations. As I hope this Subcommittee is aware, lenders support the reform efforts undertaken by the Congress and the Department of Education in the past five years.*

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[1] The Consumer Bankers Association was founded in 1919 to provide a progressive voice for the retail banking industry. CBA represents approximately 700 federally insured banks, savings and loans and credit unions that hold more than 80 percent of all consumer deposits, and more than 70 percent of all consumer credit held by federally insured depository institutions.

Today, I am placed in the difficult position of defending the student loan program against the promises of an alternative which has not yet been created or tested by real world challenges. The arguments in support of discarding the current program need to be viewed in this context.

The Various Direct Loan Proposals

There is no single federal direct loan program proposal--there are several. We have reviewed the proposal put forward by the American Council on Education and discussed it at length with ACE staff. We have also seen a proposal put forward by the Economic Policy Institute, which calls for a $20-billion-a-year program funded by the Social Security Trust Fund. CBA has sought to learn as much as we can about these and other alternatives. We chose not to publish a response until we fully understood the motivation behind these proposals.

Thus far, we have concluded that:

1. All of the proposals are drafted to take advantage of the recently enacted Credit Reform Act*. This legislation would allow OMB to raise the necessary capital for student loans as an "off-budget" item, and appropriate only the actual costs, i.e., subsidies, default payments and administrative charges. Because

federal funds are less expensive to borrow than private-sector funds, this appears as a significant federal capital savings.

2. All of the proposals suggest that a party other than the Department of Education act as the servicer of these loans. There seems to be agreement that asking the Department to directly assume the task of servicing the loans is unrealistic. Instead, proponents look to the expertise of the major loan servicers, Sallie Mae, and even some guaranty agencies to perform this function. Some proponents even suggest that schools might want to service some of the loans.

3. All of the proposals eliminate the need for a federal guarantee. The federal government would instead absorb the full amount of any default, or require the loan servicer (or some other party) to absorb part or all of the default costs.

CBA believes there are several reasons why schools support direct loans:

1. Schools do not like dealing with multiple guaranty agencies and lenders.

Lenders are well aware of the problems created for institutions by the multiplicity of forms and procedures. To help address this, CBA has suggested that a major initiative be undertaken to require standardization between the guaranty agencies.

2. Schools do not like the numerous default reduction provisions enacted over the last five years, such as delayed disbursement, multiple disbursement, entrance and exit counselling, and mandatory pro-rata refund policies.

It is unclear whether the enactment of a direct loan program would eliminate any of these default reduction measures. Low-default institutions, in particular, resent this federal intrusion.

The imposition of default reduction initiatives on low-default schools is an important reauthorization issue. However, it is totally independent from the issue of how loans are made.

3. Institutions believe enactment of direct loans would result in a dramatic increase in Pell Grant funding.

Enactment of a $4,000 maximum Pell Grant, without the modifications supported by the Administration would require an annual appropriation of between $8 and $10 billion. This represents a dramatic increase over current Pell funding that far exceeds the anticipated savings from direct loans.

Lenders believe that the GSL program, with its 20-year history of support for student borrowing, is a better foundation for a dramatic increase in Pell funding because, unlike direct loans, it is not premised on a loophole in the Credit Reform Act.

The Problems With Direct Loans

There are several major concerns that should be considered in evaluating any direct loan proposal:

1. The existing GSL program structure would be destroyed.

Once the flow of new loans and guarantees into the portfolios of lenders and guarantors ceases or is substantially reduced, virtually all lenders will initiate phase-out of their participation in the program. Many guarantors, faced with insolvency, will do the same. Twenty-five years of technical expertise will be lost to the program.

Those familiar with the history of the Guaranteed Student Loan program know that persuading lenders to make loans to students with no income and no previous credit history was not easy. Once the current program is phased-out, securing private-sector participation, if the need arises in the future, will be difficult.

2. Program accountability would be lost. Under the GSL program lenders are held responsible for failures to service loans in accordance with applicable guaranty agency and federal regulations. Guarantors face similar financial exposure if the agency's default experience exceeds five percent in any given fiscal year.

Under direct loans, this accountability will be lost. All default costs will be the responsibility of the federal government. If the loan servicer is asked to share in the risk of default, as has been proposed by some direct loan advocates, the cost of absorbing this risk will be passed back to the government in the form of a higher contract fee.

The accountability inherent in the current program is significant. In the past two years, over $400 million in federal liabilities have been avoided because of reinsurance losses by program participants. This is a significant cost factor.

3. Transition problems could be significant. An "optional" program, as proposed by ACE, would be particularly troublesome. Under the ACE proposal, it is easy to imagine students transferring to or from a direct loan school to a non-direct-loan school, thereby creating more complexity and confusion than

already exists. We also see the task of the high school and financial aid consultant becoming more difficult, since participation or non-participation in the direct loan program will be yet another subject that needs to be addressed in counselling sessions focused on the choice of institution to attend.

As the Nunn Report and the OMB/ED study made clear, management of the GSL program by ED is in urgent need of reform. To confuse this task by creating yet another loan program would add tremendously to that administrative burden. Lenders are generally enthusiastic about the new team at the Department of Education assembled by Secretary Alexander. Even if the entire GSL program is replaced with direct loans, currently outstanding GSLs have twenty or more years to run before the last payment is received from borrowers. Lenders question the feasibility of relying on ED to operate both programs simultaneously.

4. Financial problems could be precipitated among Guaranty Agencies. As this Subcommittee well knows, it was a decrease in loan volume that helped precipitate the crisis at HEAF last summer. Under the ACE proposal, national guaranty volume (and therefore insurance premium revenues) would be dramatically decreased. At the same time, the average quality of loan would decrease (since the types of institutions likely to want to and be allowed to participate in the direct loan program will be low-

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default schools).

The Department of Education has periodically suggested that as many as a half-dozen guaranty agencies may face financial difficulty. We suggest that perhaps as many as two dozen agencies could face financial difficulty if the GSL program were brought to an end.

I want to emphasize that protecting guaranty agencies is not a proper reason for supporting the current GSL program. To the contrary, a fair review of the direct lending alternative must take into account the risks and costs associated with phasing out the existing program.

5. Low-income students, especially those attending community colleges and proprietary schools, are likely to be poorly served under the new program. For the past several years, lenders have been directly and indirectly encouraged by the Department of Education and the Congress to "know your student loan customer" and to take steps to avoid bad loans. These efforts have resulted in restricted access for loans to students attending high-default-rate institutions.

While some schools are unhappy with lenders and guarantors who have made it difficult for students attending high default rate schools to obtain loans, the net result has been to reduce the cost of the current program. When lenders have suggested that this private sector safeguard would be lost under direct loans, the argument has been made that the federal government--not private sector corporations--should be deciding who does and does not get loans. Some of these critics of current practices have suggested direct loans as a cure for this problem. I believe exactly the opposite will occur.

Because the private sector safeguard against fraud and abuse will be lost under direct loans, the Department of Education is likely to make participation in a direct loan program more difficult than under the current program. Under an institution-optional program, the availability of loans through the current GSL program is likely to be very difficult, since lenders will have lost the low-risk loans they currently use to help balance out higher-risk loans.

The fact of the matter is that institutional participation in direct loans is likely to be controlled much more stringently than is the case under the current program. If it isn't, this Subcommittee should be prepared for a higher level of defaults to occur.

6. Long-term federal support for direct loans is far from certain. Because of the large capital requirements inherent in direct loans, between $12 to $16 billion per year would have to

be provided for direct loans. How likely is it that federal support for the program will be maintained at this level? Over a ten-year period $120 to $150 billion would be outstanding, with default losses of over $10 billion projected.

CBA believes a crisis could be precipitated if, in an era of severe budget deficits, this Subcommittee and the education community were faced with defending a student aid budget which, including the amount of funding provided for direct loans and an expanded Pell Grant program, amounted to $20 to $30 billion annually. The availability of private capital avoids this problem.

Several other issues raised by direct lending include:

--Loss of tax revenues currently generated by private lenders and Sallie Mae for the federal government and state and local governments.

--Increased exposure to litigation for institutions from disgruntled students resulting from the origination relationship inherent in the direct loan program.

Congress should be fixing the current GSL program--not creating a new program.

In closing, I would like to reiterate my belief that the structure of the Guaranteed Student Loan program is essentially sound. Lenders appreciate the opportunity to participate in the program and hope Congress will continue to provide us with this opportunity.

The Stafford Loan program has operated successfully for over 25 years. Lenders endorse the notion that changes are needed to better serve program beneficiaries. We stand ready to work with you toward this common goal of improved access to loan capital for all eligible borrowers.

CBA has recommended eight major reauthorization proposals, several of which are directed at simplifying the administration of the Stafford Loan program by mandating standardization and negotiated rulemaking. A copy of these recommendations has previously been inserted into this Subcommittee's hearing record.

In moving into to the mid-1990's, CBA is hopeful the successful public/private partnership, which is the hallmark of the Stafford Loan program, will continue.

Thank you for the opportunity to testify before you today. I will be happy to respond to any questions that you or other members of the committee may have.

(105A705)

CBA REAUTHORIZATION PROPOSALS

The Consumer Bankers Association (CBA) believes that the reauthorization of the Higher Education Act should focus on the important social objectives of the program. In the last several years, rising education costs and inadequate growth in Pell Grant funding have led to increasing numbers of low-income students relying on student loans rather than grants to attend school. A failure to correct this trend will result in the further erosion of educational opportunity and lead directly to a decrease in access for students with the greatest economic need. The result will be a decline in America's ability to compete with other nations. Therefore, CBA endorses the efforts of Senator Pell (D-RI) and Representative Ford (D-MI) to increase grant assistance through vital expansion of the Pell Grant program.

The Guaranteed Student Loan programs represent a dramatically successful public - private partnership designed to achieve a valued social goal. In order to preserve and enhance that partnership, CBA has identified eight legislative priorities for the pending reauthorization of the Higher Education Act of 1965, as amended:

1. Simplified administration of the program through the use of modern data processing. CBA strongly endorses the elimination of unnecessary paperwork in the Guaranteed Student Loan programs. Record-keeping and loan administration practices in the student loan industry have fallen behind standards generally applicable to the consumer loan industry. Methods of record retention including microfilm, microfiche, laser disc, computer disc, and image optics should be utilized by the Department of Education to eliminate the storage of paper record-keeping beyond the loan application and the promissory note. Regulations issued by the Department of Education should accomplish the following:

- simplify all aspects of the student loan process including application, disbursement and origination;
- improve communication between lenders and guarantors by requiring the use of uniform reporting documents (this would also enhance borrower understanding of their loan obligation);
- simplify fulfillment of institutional responsibilities under this part by institutions of higher education; and
- improve the administration and oversight of the program by the U.S. Department of Education.

2. Simplification of borrower deferments. Under current law, eleven separate deferment categories allow borrowers to defer loan repayment. The proliferation of deferments has increased the complexity of program administration and has proven to be confusing to borrowers. Congressional intent in instituting deferments was to recognize the legitimate need for financial relief for borrowers in certain circumstances. CBA recommends the elimination of all deferment categories except the time periods during which a borrower is enrolled as a full-time student; and documented instances of economic hardship, such as unemployment or total disability. Lender use of forbearance allows all other borrower circumstances to be fairly and appropriately considered.

3. Due diligence procedures. Major lenders and servicers are in agreement that the due diligence regulations are too rigid and result in a higher priority being placed on maintaining compliance with the regulations than on loan collection. The Department of Education acknowledged the problems caused by the regulated standards currently in effect and recommended revisions to the thirty-day "bucket" system in the NPRM for the 1986 Higher Education Act Reauthorization in November, 1990.

It is CBA's view that the collection practices of a lender should be measured and taken into consideration when claims are approved or denied for payment. By establishing a tolerance rate for errors, lenders could concentrate on enhanced loan collection efforts rather than lock-step compliance with required letters and phone contacts which may or may not contribute to a borrowers repayment of the debt.

By imposing a percentage guideline for compliance, any lender who maintains a pre-determined performance rate standard (for example, 95 percent) on completion of mandatory due diligence steps would be assured full payment of insurance, interest and special allowance on loans made. This compliance would be monitored on a annual basis during the mandatory audit of a lender's portfolio. The audit would be paid for by the lender, monitored by the Department of Education, and performed by an independent third party auditor. Parameters of the audit, as defined by the Department, would follow standard accounting practices and would include a defined statistical sampling technique upon which a lender's performance would be measured. The performance measurement derived from the audit would be used by all guaranty agencies with whom the lender has participation agreements to determine how claims were to be paid. Lenders whose samples are found to be above the standard would be reviewed for proper monetary and technical data. Failure to maintain compliance at or above the defined standard would result in a full review of each file for the given time period and the assessment of prescribed penalties. Without the threat of inordinate penalties for inconsequential regulatory violations, the lending community would attempt collection innovations which emphasize the true spirit, rather than the exact letter of the law.

4. Procedures for handling insolvency of a guaranty agency. CBA believes that the statute should require guaranty agencies to operate on a sound actuarial basis. Furthermore, the statute should define steps to be taken by the Secretary of Education in the event of a guaranty agency solvency. In light of the recent collapse of the Higher Education Assistance Foundation, interest in these proposals has increased among the Congress and the Administration. Therefore, CBA recommends that the Act should require the Secretary of Education to do the following:

1. Periodically re-evaluate the solvency of all guaranty agencies.

2. Identify agencies which fall below specified federal standards relating to reserve ratio and/or other indicators of administrative and financial viability and require such agencies to: (A) operate under a guarantee management plan approved by the Secretary, (B) if appropriate, overcome a short-term cash flow problem through the receipt of additional repayable advances, (C) merge their operations with a stronger agency, or (D) terminate their operations and assign responsibilities for outstanding guarantees to the Secretary. After consultation with lenders, it would be the Secretary's prerogative to transfer such guarantees to a solvent agency.

3. Require the Department to publish the results of an annual survey of guaranty agencies to facilitate lender evaluations of agencies.

5. Use of negotiated rulemaking procedures to promulgate Title IV regulations. A recent GAO briefing report verified that the Department of Education rarely complies with the statutory requirement that regulations be promulgated within 240 days of legislative enactment. The regulations necessitated by the passage of the 1986 reauthorization of the Higher Education Act are not yet finalized; the NPRM did not appear in the Federal Register until November, 1990. Given the significant liabilities imposed on lenders, secondary markets and guaranty agencies for failure to properly administer the GSL program, the issuance of clear and timely guidance about legislated program changes is imperative.

The complexity of the GSL program is such that the Department of Education and the higher education community stand to benefit from early and direct communication about these mandated regulations. Early consultation can serve to educate the community and sensitize the Department to potential problems regarding implementation. For these reasons, CBA supports the use of regional meetings and negotiated rulemaking procedures in the development of regulations to govern the implementation of the reauthorization of the Higher Education Act, as was required, with certain modifications, in recent reauthorizations of the Elementary and Secondary Education Act and the Vocational and Adult Education Act. The use of negotiated rulemaking to promulgate regulations governing the implementation of Title IV should in no way be seen as a substitute for the useful and ongoing communication and issuance of Dear Colleagues which the Department presently undertakes with the higher education community.

6. Insurance to lenders. CBA believes that the requirement that guarantors offer 100 percent insurance to lenders as a condition for insurance program agreements with the Secretary is critical to maintaining open access to loans for all borrowers. The program already involves significant loss to lenders. Even with a 100 percent guarantee, lenders face significant losses because of strict due diligence penalties; and penalties resulting from retroactive regulatory changes that affect pre-existing loan agreements. Lender profitability has been reduced (GAO/HRD 90-130) and lender participation in the program has diminished as a direct result of this increased financial risk.

In the past, lender risk sharing has been put forth as a means of default reduction. There are preferable means of achieving this legitimate goal. CBA has proposed, for example, that lenders be given additional flexibility in fashioning collections procedures. It should also be noted that Congress has enacted numerous bills and amendments aimed at reducing GSL defaults. Remaining default reduction options such as stricter school cutoff rates or co-signer requirements will only serve to reduce access to loans for those potential borrowers most in need of financial assistance in order to pursue higher education.

7. Special Allowance. The special allowance paid to lender participants in the GSL programs is calculated by adding 3.25 percent to the 91-day treasury bill rate. The 1989 CBA Student Lending Survey found that the return earned by lenders in the GSL program was typically less than that earned on other consumer loan products. As the cost of funds and operational costs associated with the student loan business continue to increase, financial managers at lending institutions will revaluate their level of participation in the program. In order to maintain open access to loans for all eligible borrowers, the current special allowance calculation should be preserved. Additionally, if Congress determines that high-risk borrowers should continue to have access to GSLs, enactment of a higher special allowance to increase the return to lenders on loans made to such student borrowers should be considered.

8. Loans for middle-income students currently ineligible for guaranteed student loans. Students determined to be ineligible to borrow under congressional methodology remain eligible for unsubsidized Guaranteed Student loans. Because these loans are unsubsidized and offered at 8 percent, they are made by very few lenders. The Supplemental Loans for Students program (SLS) makes unsubsidized, guaranteed loans available to independent students and, in special circumstances, dependent borrowers, but many middle income students who need financial aid remain unserved.

CBA endorses a proposal put forth by NCHELP to expand loan access to guaranteed but unsubsidized loans to all eligible students. Under the NCHELP plan, only those students showing financial need would continue to be entitled to in-school interest benefits through subsidized Stafford loans. Unsubsidized loans would be available to those not qualifying for full subsidized Stafford loans. Interest on the unsubsidized loans that accrues during in-school, grace, and deferment periods would be paid either quarterly or capitalized, as agreed upon by the lender and the borrowers. Borrowers would pay a 5 percent reinsurance premium to offset the costs associated with defaults. The NCHELP proposal does not contain a specific proposal for an interest rate on unsubsidized loans. It is assumed that a rate would be set to eliminate any special allowance in all but extraordinary circumstances.

105/B/9

Mr. **Andrews**. Thank you very much. The final member of the panel is Ms. Patricia Smith who is Director of Legislative Analysis for the American Council on Education in Washington, DC.

Ms. **Smith**. Thank you, Mr. Chairman. I would like to thank the Chairman for giving me the last word on the panel.

I am here to represent the higher education associations that are listed on the front of our testimony, and that is 13 associations, including the American Council on Education, with our proposals for changes to be considered in the Federal loan programs during reauthorization, with particular emphasis on direct Federal lending.

The Guaranteed Student Loan Programs and the Perkins program have served institutions of higher education and students in those institutions well during their history.

For many students, particularly those in the $30,000 to $60,000 range, income range, a Stafford loan is the only form of Federal need-based aid which they receive.

We are also pleased to support the supplemental loans for students and parent loans, and we have specific recommendations in our testimony for improvements, particularly in the parent loan program, because we would like to encourage the parents to do as much borrowing as possible to try to minimize student borrowing.

We have already recommended before the committee a dramatic increase in the Pell grant maximum award and reform of the Pell grant formula for computing awards to reduce the need for low income students to borrow, but unless funding for grants can be increased severalfold, we are quite aware that both low and middle income students will continue to need access to loan capital in the coming years.

As my late friend, Fred Fisher from the Office of Management and Budget, taught me, loans are cheaper than grants any way you look at it.

We are in addition pleased that some of the recent studies from the Department of Education indicate that college graduates are being successful in repaying their loans. The average student who graduates from college seems to be able to repay their guaranteed student loans and other loans without excessive burden.

But we are quite aware that there are problem groups of students in the loan programs, and the severity of the loan burden for some of these groups can be substantial, including the high risk students who do not finish their college program, who cannot repay loans on a regular, amortized basis, and end up in default in the guaranteed student loan program.

In addition, there is substantial evidence, anecdotal evidence at least, that many students are increasingly reluctant to undertake certain academic programs and careers such as teaching and public service which do not guarantee high incomes.

For these reasons in addition to our proposals in our legislative package, to continue the Federal loan programs and increase the loan limits in these programs, we have several recommendations to try to make repayment more manageable for all students and to assure that Federal loan programs are not punitive to at-risk borrowers who are willing to repay but are not able to repay on standard schedules.

One of those recommendations is for a flexible repayment program that would be a modification to the current Federal programs to provide income contingency on an exception basis which we believe would be more manageable than a loan program in which all borrowers repaid on an income contingent basis, and we have specific details in our package for how such a program would work.

Since we are asking for substantial increases in loan limits, and since we are asking for special programs such as flexible repayment, which is relatively—which would require some modification of existing programs and relationships between the various players, in addition we are making this proposal that has been alluded to by others of my colleagues at the table for a direct Federal lending program which would be an option to the Stafford program with possible terms and conditions.

We do believe there is a chance and some evidence that indicates that student subsidies would be less costly under a direct Federal lending program than in a program subsidized using bank loans, and we think that flexible repayment would be substantially simpler under such a program.

As Mr. Butts has documented, and as Mr. Petri alluded to earlier, one of the things that has made all this discussion possible is the passage of the Budget Enforcement Act which has equalized the playing field on the differences with Federal treats direct loans and guaranteed loans. In the past there was a bias in favor of guaranteed because there costs were deferred, and the previous treatment distorted cost comparisons, as CBO has pointed out, between Federal credit and non-credit programs.

For example, the cash basis cost of a direct loan in a fiscal year was equal to the cash basis cost of a grant, whereas the long term cost of a direct loan can be much less than that of a grant because of the loan repayments, and credit reform has provided the level playing field.

We recommend that this option for direct Federal lending for need based loans be added under the mandatory spending limit in the budget to assure that adequate capital is available, as Mr. Butts suggested, as an entitlement to students and that direct Federal loans do not compete with grant funding under the discretionary spending cap.

We think the Federal Government should provide funds under this program to institutions to elect to participate. For related administrative burdens such as loan origination institutions should receive compensation from the Federal Government for costs incurred.

We have suggested as a place holder in our document twenty dollars per loan. We emphasize that this proposal is not for institutional lending; that this is a proposal for direct Federal lending with the institution simply acting as the agent of the Federal Government in originating the loans, and that the Federal Government would provide collection services through contracts or agreements so institutions would not have to service the loans that were originated.

Some institutions might not elect to participate in the direct Federal lending program, but we think the department should encourage start-up participation and take steps to insure that those which participate in the start-up comprise a cross section of the universe of institutions in order to develop a broadly based program.

After the program has been operational for several years, we believe the information generated should be sufficient to expand the program and better delineate the future roles of State guarantee agencies and secondary markets.

In conclusion, we believe that the costs of this program could be substantially less than the current program and that it is worth the option to explore to see if that billion to a billion and a half savings could materialize.

If there are further questions later, we would be glad to respond to them.

[The prepared statement of Patricia Smith follows:]

STATEMENT

to the

SUBCOMMITTEE ON POSTSECONDARY EDUCATION

COMMITTEE ON EDUCATION AND LABOR

UNITED STATES HOUSE OF REPRESENTATIVES

June 12, 1991

by

Patricia Smith
Director of Legislative Analysis, American Council on Education

On behalf of:

American Association of Community and Junior Colleges
American Association of State Colleges and Universities
American Council on Education
Association of American Universities
Association of Catholic Colleges and Universities
Association of Community College Trustees
Association of Urban Universities
Council of Independent Colleges
National Association for Equal Opportunity in Higher Education
National Association of College and University Business Officers
National Association of Independent Colleges and Universities
National Assn. of Schools and Colleges of the United Methodist Church
National Association of State Universities and Land-Grant Colleges

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to testify today on behalf of the undersigned associations on changes to be considered in federal loan programs during the reauthorization of the Higher Education Act, with particular emphasis on direct federal lending.

The Guaranteed Student Loan (GSL) programs and the Perkins loan program have served students enrolled in higher education programs well over the years. For many students, particularly those in the $30-60,000 income range, a Stafford loan is the only form of federal aid which they receive. For lower income students, a Stafford or Perkins loan has been a necessary adjunct to a Pell grant if a student wants to attend a residential public institution, or attend a higher-priced independent institution.

Gradually, the Supplemental Loans for Students (SLS) and parent loan (PLUS) programs have grown in importance. Supplemental Loans have been used increasingly to supplement Stafford loans or assist students not eligible for Stafford loans, particularly in financing graduate education. We particularly support the PLUS program, which provides assistance to parents and thereby minimizes student debt.

We have already recommended a dramatic increase in the Pell Grant maximum award, and reform of the Pell formula for computing awards, to reduce the need for low-income students to borrow, but unless funding for grants can be increased several fold, both low- and middle-income students will continue to need access to loan capital in the coming years; it is important that federal programs provide sufficiently flexible repayment terms that students are not excessively burdened with repayment.

Some of the recent analyses by the Department of Education and other groups on the borrowing and repayment experience of college graduates are encouraging. Students, parents, and institutions are working together to minimize students' debt, and it appears that the average student is not borrowing up to the Stafford loan limits. Further, average college graduates find a good job and repay at substantially less than 10 percent of their income once they complete their education program. But problem students fall into several categories, and the severity of loan burden for these groups can be substantial.

The Student Loan Marketing Assocation's recent testimony is useful in describing some of the groups of students who are not well-served by the existing programs, such as non-traditional students, and we plan to explore with them proposals for modifications to address these problems.

Further, in the absence of sufficient grant funds, some high-risk students must borrow, sometimes substantially, in order to finance equal educational opportunity. Unfortunately, many of these students do not complete their academic program and cannot repay their loans on regular amortization schedules because they may not have remained in college long enough to improve their standing in the job market, and have trouble finding a job with sufficient income. Similarly, many at-risk students are apparently intimidated by borrowing, and are reluctant to attempt baccalaureate programs, electing short-term vocational programs, in which they incur often incur less cumulative debt than would be involved in a longer-term program, but which allow them limited flexibility in other employment if they are unable to find work in that field.

Even among students from higher-income families, there is substantial anecdotal evidence that many students are reluctant to undertake academic programs and careers, such as teaching and other public service, which do not guarantee high incomes because of fear of not being able to repay loans without extreme hardship.

The worst aspect of the student loan default problem may be that students who attempt college by financing their expenses with loans but do not succeed and default on their loans are worse off after their attempt than they were before. They owe the federal government the money and are pursued by collection agencies, their credit is ruined, and their educational experience is officially categorized as failure because of the financial implications of not being able to repay. They are eliminated from Title IV eligibility and cannot resume academic preparation that may help reduce their loan liability.

For all these reasons, in addition to our proposals to continue the federal loan programs and increase loan limits, we have several recommendations to make repayment more manageable for all students and to assure that federal loan programs are non-punitive to at-risk borrowers who are willing to repay but are not able to repay on standard schedules.

Following are our specific proposals for modifying the Guaranteed Student Loan Programs:

(1) We propose that lenders be required to provide graduated repayment schedules, which are now available only at lender option.

(2) We concur with the proposal of the Consumer Bankers Assocation and others that deferments be consolidated into one easily understood hardship deferment.

(3) We do not believe, however, that even these improvements will solve the problems of the student who has longer term employment problems, and therefore propose a flexible repayment option.

This flexible repayment proposal would provide income-contingency on an exception basis, which we believe would be more manageable than a loan program in which all borrowers repaid on an income-contingent basis. Under this proposal, the borrower in repayment whose debt exceeds his annual income, or whose debt service exceeds 10% of income, could petition the state guaranty agency for an income-contingent repayment schedule. At this point, the state agency would purchase the loan from the lender with federal funds and the student would repay the loan to the state agency, which would reimburse the federal government. One further option for consideration would be, if the loan were not totally paid at the end of 20 or 25 years, to forgive the remainder. The small subsidy involved could be financed either by the federal government or by a small student fee paid by all students.

(4) We recommend the elimination of the Income Contingent Loan (ICL) program, which we believe is unfair to students who have high debt and low incomes after leaving school, because it imposes excessive interest payments.

(5) We recommend that the student interest rate in the Stafford program continue to be 8% during the first four years of repayment, but that in the remaining years, it be made variable, e.g., 91-day T-bill plus 3.25% adjusted annually, with a limit of 12%. If T-bill interest exceeded 12%, then the federal government would pay lenders a special allowance.

(6) We recommend that PLUS loan limits be removed so that parents can borrow up the cost of the student's education, minus other aid, subject to appropriate credit restrictions, to reduce the need for students to borrow.

(7) We recommend that loan limits in the GSL programs be increased to compensate for inflation since the 86 Amendments. Specifically, we recommend that the limits for both Stafford and Perkins be set at $3500 for freshmen, $5000 for sophomores, juniors, and seniors, $10,000 for graduate and professional students. The undergraduate limits are similar to those recommended by the Administration. Aggregate limits would be increased in both programs to $23,000 for undergraduates and $73,500 for the total undergraduate/graduate limit. The SLS limits would be $4000 for freshmen, $6000 for sophomores, juniors, and seniors, $10,000 for graduate students, and the aggregate limit would be $78,000.

We have included legislative language to implement these proposals in the package which we submitted to the subcommittee on April 8. We are aware, however, that they would increase the cost of the GSL programs, particularly the Stafford program, and that a method of financing these increased benefits must be identified under the mandatory spending cap with its "paygo" provision.

(8) Finally, therefore we make an important proposal for a direct federal lending program which would be an option with comparable terms and conditions to the Stafford loan program. We believe student subsidies would be less costly under direct federal lending than under a program based on subsidized bank loans, and which would make flexible repayment simpler since the federal government would own the loan paper from the time of origination.

Prior to passage of the Budget Enforcement Act (BEA) last year, the differences in the federal budgetary treatment between direct loans and guaranteed loans created "a bias in favor in guarantees because their costs [were] deferred...It also [distorted] cost comparisons between federal credit and noncredit programs. For example, the cash-basis cost of a direct loan in a fiscal year [was] equal to the cash-basis cost of a grant. The long-term cost of a direct loan, however, may be much less than a grant because of loan repayments." (Congressional Budget Office, 1989) Credit reform, which passed as part of the Budget Enforcement Act, created a level playing field between direct federal lending and guaranteed loan programs. For both kinds of programs, the federal budget now tracks the estimated present value of the subsidy of the cohort of loans made each year; it does not score the face value of loans made under a direct federal program.

At the same time we propose direct federal lending for need-based student loans, we support continuation of federally-guaranteed loans made by banks for parents and students. We recommend that the option for direct federal lending for need-based loans be added under the mandatory spending limit to assure that adequate capital is available as an entitlement to students and that direct federal loans do not compete with grant funding under the discretionary cap. The amount of capital available each year should be determined only by student eligiblity, and should not be subject to an arbitrary fixed limit.

We propose that institutions with sufficient administrative capability be offered the option of participating in direct federal lending as a substitute for Stafford loans made by banks. The federal government should provide funds for loans to institutions which elect to participate. For related administrative burden such as loan origination, institutions should receive compensation from the federal government for costs incurred. The federal government should provide collection services through contracts or agreements so that institutions do not have to service loans originated. Many institutions may elect not to participate in direct federal lending, but the Department should encourage start-up participation and take steps to insure that those which participate in the start-up comprise a cross-section of the universe of institutions, in order to develop a broadly based program. After the program has been operational for several years, the information generated should be sufficient to expand the program, and better delineate the future roles of state guarantee agencies and secondary markets.

We believe that direct federal lending can provide substantial savings; previous analyses of the federal costs associated with the Stafford and Perkins programs indicate that the present value of the subsidy in those two programs is relatively close, even with the lower Perkins interest rate. If a direct federal program charged borrowers a rate comparable to the Stafford rate, we believe that it could achieve savings due to the federal government's relatively low cost of funds and reduced federal cost during the in-school period. The current special allowance payments to banks, in concert with student interest, is structured as an inducement for banks to make capital available, as well as covering the cost of operations and profit margin, and could be eliminated.

To achieve further savings, we support several recommendations proposed by the Administration, including their collections enhancement provisions, reduction in Stafford maximums for one-year programs, and the elimination of programs of less than 6 months or 600 clock-hours.

Finally, we emphasize that that our loan proposals should be augmented by progressive savings plans that encourage students and their families to save for college, to reduce dependence on debt and improve the nation's savings rate.

Chairman **Ford**. Thank you very much. As I look at your flexible payment proposal, you would make the determination after you were in a position where you are going into repayment as to whether or not a person was eligible for consideration for flexible repayment.

Ms. **Smith**. That is correct.

Chairman **Ford**. As I look at it, if the debt exceeds the person's annual income at that point, or the debt service exceeds 10 percent of income at that point, they would be eligible to apply.

Ms. **Smith**. Right; that is correct.

Chairman **Ford**. How is that different than the present ability to bundle your loans together and negotiate a repayment schedule up to 20 years; loan consolidation, we call it?

Ms. **Smith**. Under loan consolidation there is no sensitivity to what the person's income is so even though, if they are—though their repayment schedule would be extended, say, to 20 years if that amount of the monthly payments exceeds 10 percent of their income, that would still be what they would owe, and in our proposal we would specify that the person did not have to repay more than 10 percent of their income.

The Secretary would be charged with developing repayment schedules so that the person did not have to repay more than 10 percent of income.

Chairman **Ford**. But that 10 percent would continue to slide as income went up?

Ms. **Smith**. Yes, and the person would have to submit income tax forms to justify that.

Chairman **Ford**. And if a person was, for example, a medical resident at the time that they exercised this option, and later jumped into the normal country club earnings of doctors, at that point their income would considerably exceed the annual cost of their loans under the original repayment and considerably exceed 10 percent of the servicing fee. Would they then click back into repayment?

Ms. **Smith**. That is our proposal; yes, sir.

Chairman **Ford**. They would no longer be income-contingent even if their income went above those?

Ms. **Smith**. That is correct.

Chairman **Ford**. So the same factor that took you in would take you back out?

Ms. **Smith**. That is right.

Chairman **Ford**. That makes more sense to me than what I thought I read.

Mr. Butts, the direct student loan proposal that was floated some time ago, according to the newspapers, by people in the department, it looks like no one wants to admit they are the father. We can't find anybody who will accept responsibility for this idea, but a lot of us got kind of excited about it, and I have discussed it with you before, and you point out here that there are 12 education organizations that submitted a form of direct loan program to us by the April 8 filing that we had asked for, and that your testimony was intended to update that.

I suppose if no one in the administration wants to step forward and assume any responsibility, it is going to be very hard to get their cooperation in forming such a program.

How do you react to the proposal that ACE brings us this morning to have a supplemental trial program running on a parallel track with the regular Stafford program with private lenders?

Mr. BUTTS. The land grant universities have endorsed the direct loan proposal that was submitted by the American Council on Education. Our interest is to take that idea as far as it reasonably could go and see if it might possibly be used as a substitute for the Stafford Loan Program.

As this process goes forward and people learn more, and we see the pros and cons, we will see which direction ultimately is in the interest of the Congress. The bill language that was in the ACE proposal would essentially drive the proposal that we have been discussing.

You could do it for a few schools. You could replace Stafford with it. The essential language has been submitted to you. What I have described basically flushes out that idea.

Chairman FORD. How do you protect against a parallel program creaming the clientele out there and giving us a set of comparisons that don't mean anything? How would you guarantee if it was truly a test of the program if you let only the bigger, stronger schools with the lowest default rates participate in it, or if they were the only ones attracted to it?

Mr. BUTTS. If that couldn't be worked out, that might argue for actually substituting direct lending for the need based Stafford Loan Program.

Some have said, "Why are we interested in doing away with a program that is 25 years old?" Well, there is another program that is 33 years old called the Perkins Loan Program that has been tested and has worked well and has delivered money essentially to needy students, and what we have had over the course of the last 10 years, 15 years, is a switch of the guaranteed student loan program from being a middle income program to being a program targeted on students with financial need.

In our proposal you will see that we are trying to refocus the existing GSL program by calling for an expansion of the parent loan program and increasing the limits in that program to cost of education minus other financial aid.

Now, that would do two things. One, it would help, obviously, middle income families, but it would reaffirm the role of the GSL program as a program between the lending community and essentially middle income families, and it would do one other thing that we weren't able to do in the earlier days with respect to the GSL program when it was a middle income program.

At that time if a student borrowed the full amount, in effect the student was borrowing the parent contribution, and by expanding the parent loan program, you can keep the parent responsibility where it belongs and keep the repayments on the parents where it appropriately belongs in terms of the relationship between who should be paying for higher education.

Ms. SMITH. Mr. Chairman, may I add a point, reinforce a point, that we made in our testimony, that we are sensitive to the point that you raised that we do not only have elite institutions in this first group, if the option were legislated and that we, therefore, precisely do believe that the Secretary of Education should be actively encouraged and directed to try to make sure that it is a cross-section of institutions.

From our own conversations we think that you could get a cross section of institutions to participate in the options so that you didn't just have the elite institutions with the larger administrative capacity.

Chairman FORD. Well, I don't want to suggest that the Education Department makes a habit of turning things out before they are fully baked, but I have a strong suspicion that as everybody is running away from this idea now, the excuses they are throwing up have to do with the fact that people didn't really think this thing through very carefully.

We had an exchange in front of the committee a week or so ago with a number of people down there who were sort of interested and then questions were asked by members over here about how much would we actually save; the original hoopla that went with this announcement was over a billion dollars a year. As recently as the last couple of days I have read that people are still saying a billion to two billion dollars a year could be saved, and they are looking at the special allowance, in school and after school, that is paid to the bankers.

If you only look at that, it looks like there is a lot of money to be realized, but if you then try to figure out what it would cost to administer such a program, it gets to be a different picture, and the people who were asked about this before had no real idea about how you would go about studying this phenomenon to determine what it would cost to run it.

Does anybody at the table have any idea about that?

Mr. BUTTS. Mr. Chairman, I think the response that you get to your request to the department for its background materials, direct lending, should answer the questions of how much it would cost for administration and the overall savings. They have had some of their best people, I believe, working on this proposal over the course of a long period of time, and it strikes me that that information would, when available, would help this discussion very significantly.

It may well be that there are other reasons to not move ahead, but I think that that analytical work would be helpful for the committee to have.

Chairman FORD. Well, since you mentioned it, without objection I would like to place in the record at this point my letter of April 25 to the Secretary asking about their testimony on the Senate side in which they said they are still considering alternatives that would replace some or all of the GSL programs. We asked them for the background on how they developed the program to see if we could learn anything from it.

[The information follows:]

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April 25, 1991

The Honorable Lamar Alexander
Secretary
U.S. Department of Education
400 Maryland Avenue, S.W.
Washington, D.C. 20202

Dear Mr. Secretary:

As you know, the Subcommittee on Postsecondary Education is undertaking a complete review of the student aid programs as part of the reauthorization of the Higher Education Act.

Our committee is moving ahead with an active hearing schedule which we hope to complete by the end of July. Legislation will be adopted this fall.

I was interested by your testimony before the Senate Labor and Human Resources Subcommittee on the Arts, Humanities and Education on April 11, 1991, in which you stated that you are "still considering alternatives that would replace some or all GSL programs."

I assume this means that a direct loan program as an alternative to the Stafford Loan Program is still under consideration. This is an idea that has also stimulated substantial interest among members of the Subcommittee. In addition, several organizations from whom the Subcommittee has solicited recommendations have recommended variations on the direct loan concept. Therefore, I expect this idea to be seriously considered during the reauthorization.

I am sure that a significant amount of high quality analytic work has been done by the Department on direct loan options and proposals. In order that the Subcommittee's deliberations on this matter may be informed by the best available information, I would appreciate it if you could share with the Subcommittee any background analyses, budget estimates, proposals and options and other relevant materials that have been produced by the Department on direct loans.

If you have any questions about this request please contact me directly or Thomas Wolanin, Staff Director of the Subcommittee.

Thank you in advance for your assistance.

With kind regards,

Sincerely,

WILLIAM D. FORD
Chairman

WDF/tww

Chairman **Ford**. Now, without prejudging the wisdom or lack thereof of such a proposal, I think it would be on our part a form of negligence if we didn't at least consider it, and see what we can learn about that as an alternative. I was here when we passed the guaranteed student loan program, and I said at the very beginning of my service on this subcommittee this time that even the things that were written by Bill Ford were not sacred in the Higher Education Act, and nothing was sacred, if we could do something better looking at the future and also looking at the past to learn from mistakes.

I don't think this committee wants to go through the reauthorization without giving a fair and thorough examination of a direct loan alternative, but we don't have before us anything upon which we can make that kind of a determination. We haven't yet had an idea—even, apparently, the people who would rather not have a direct loan program feel no threat in the fact that we are even looking at it because nobody has suggested a study.

Usually the way you get rid of something that you don't want is to require a study, and I have been waiting for somebody to suggest a study, and the fact that we don't have a study suggested means that they think that guaranteed student loans are going to be as they always were. Nothing is going to change.

I know there are people here who will appreciate it when I say to them, "Don't count on it. Don't count on it." We have to have some explanation when we finish this process for why, if we do nothing, we did nothing, to examine the potential of a program that could realize an extra billion or two billion dollars a year in student purchasing power rather than profits for lenders.

I don't intend that when we finish we will say that we had some suggestions and we brushed them off, but at the same time I don't intend to support some new idea just because it is new and dramatic that is going to get us back into the soup with nobody willing to make those loans out there after we get through muddling around. We can't muddle around in a way that destroys further the confidence in the program.

I thank you on the panel, and you particularly, Mr. Butts, for the direct way in which you approached this in your testimony today.

Mr. Coleman?

Mr. **Coleman**. Mr. Belew, we have heard a number of comments through out the years concerning institutions we have gone after for excessive default rates and we have tried to make certain institutions that have not provided their students with sufficient opportunities ineligible for support. Their students leave and don't come back to pay their loans. There are high default rate institutions, and we find that there are some lenders who might fall into that category as well. They seem to have lending recipients with a higher default rate as well.

Do you have any concern about looking at the lender as another player in this activity? And are there links to some institutions with higher default rates like schools have higher default rates? And what steps might we consider, if any, to correct the lender in this process? Would you have any comment on that?

Mr. **Belew**. I have a couple of reactions to that. First of all, no, we wouldn't have any concern about that. I think lenders are under increasing scrutiny and probably should be in general.

Lenders have also been, at least through our activities—I hope we have been helpful in trying to work on default reduction procedures over the last—any number of acts that have been passed.

It seems to me that part of the problem there is that you are going to find different relationships between certain lenders and certain schools, and we have all been trying to grapple with the question of a proper accreditation or proper technique to evaluate, really, how to deliver true, quality education to any eligible deserving borrower, consumer.

So I would look forward in the process to working more on the accreditation side, perhaps. It is a very difficult question, one that we have all grappled with for a number of years, but I don't believe the lending community is shy about being examined, though, is the short answer to your question.

Mr. **Coleman**. Do you currently have, or don't you have, the opportunity to pass up some loans in favor of others? In other words, not just based on accreditation but experience at an institution?

Mr. **Belew**. That is correct.

Mr. **Coleman**. You do that now, and to a certain extent you create a credit profile?

Mr. **Belew**. Are you speaking about a particular learning institution?

Mr. **Coleman**. Yes.

Mr. **Belew**. That is true.

Mr. **Coleman**. And students who may be planning to attend your institution and approaching it for a loan, may take that into consideration as to whether or not there is a loan available for them.

Mr. **Belew**. Well, we do that also partly at the suggestion of the department and through the process.

Mr. **Coleman**. Now, as the Chairman mentioned, and I was planning to bring this up as well, this direct loan program and the impact of savings that is being discussed, and as he indicated, it might be a billion dollars. It might be more than a billion dollars that could be saved by taking the banks and other so-called middle men out of this current process.

On to the other side of the ledger: we don't know how much to add to the other side of the ledger. If we beef up all these people at the department, we are going to have to hire more people, et cetera, et cetera. But assuming there is a billion plus currently in the pipeline in the system we have created, how much of that billion do you think the banks share? A third? Two thirds?

Mr. **Belew**. I don't know that we could make an estimate. You know, when this first came up, and people started talking about a billion dollars, I think anybody could understand why you would get excited about that. That starts to sound like serious money. But as you go in, and we have tried to make some, I hope, fairly objective comments in our testimony about some of the other add-back-in factors: certainly, the administrative costs, perhaps the losses on the default side through less diligence or fewer checks and balances

Mr. **Coleman**. Well, if you can't answer the question, I understand, but what we hear up here is, that the banks are either making a whole lot of money on this program, or the banks are losing a whole lot of money on this program.

I want to know, of the billion dollars that could be saved initially, before it is applied to the other side, if—the banks will certainly get a share of it? Then my next question is, does the CBA have any sort of total bottom line figure to determine if this is or is not a profitable venture? If so, how much of a margin is there on the bottom line, so that those people who talk about risk sharing, who criticize the banks, who want to reduce the special allowance, and all the comments I have heard from your association through the years that have encouraged you to participate, is, in fact, necessary and meaningful?

If you don't have those answers today, I would like to see them because I think it would be helpful for us as we look at the various proposals.

Mr. **Belew**. To the extent that we can develop those, I will submit those for the record, but maybe the best way to answer your question, if I understand, is relatively how profitable and how important is the student lending product to the banking industry? Now, the banks who belong to the Consumer Bankers Association don't all participate in a large way in student loans. It happens that most of the biggest players in the market are members of our association so we are a good clearinghouse for information.

No one has been able successfully to determine exactly—we measure profitability in basis points, as you know; how many basis points the industry standard is on student loans.

It is very much our impression that they are slightly under other consumer retail banking products, automobile products, home equity loans, credit cards, what have you. That does not argue that they are unattractive. They are attractive for any number of reasons, but it is more of a marginal business, quite frankly, than a number of the other mainstay products.

Mr. **Coleman**. Mr. Saleh—I hope I pronounced your name correctly.

Mr. **Saleh**. Saleh.

Mr. **Coleman**. Saleh. Would you please explain some of these onerous regulations specifically? What might they be that you desire to exempt Cornell, and other institutions with a low default rate? What rate would you suggest shows a, quote, "strong GSL track record?" Strong enough that you would exempt them from these onerous regulations?

Mr. **Saleh**. Certainly. Several that come to mind immediately as mentioned by other members of the panel, the need to do entrance interviews. For example, when we have a default rate of less than 1 percent, we believe that we could construct our entrance interviews, as we have in the past, in a different way where we have provided the students information in writing and in discussion as we talk to students, but I think that that is one example where we have to hold up the process for students and cause them to come into our offices for entrance interviews. That really adds an administrative burden.

The new regulation that is upon us starting in the fall where we are required to hold checks for first year borrowers for up to 30 days is one that I think is going to be a significant problem. It creates an administrative problem——

Chairman **Ford**. Excuse me. Would the gentleman yield?

Mr. **Coleman**. Sure.

Chairman **Ford**. Did you really mean to say that you are required to hold the check for 30 days?

Mr. **Saleh**. We are not allowed to have the student sign a check, a Stafford loan check, until they have been in attendance for 30 days so I didn't state that exactly correctly, but our classes will start on August 25.

Chairman **Ford**. The 30 days that we required was a 30-day delay in disbursement. All right? Now, the check isn't written by the bank in advance of the 30 days, is it?

Mr. **Saleh**. I believe it will be.

Chairman **Ford**. When does the interest start running on that loan?

Mr. **Saleh**. At the time that the bank issues the check.

Chairman **Ford**. So we are paying interest on 30 days that the student doesn't have the money?

Mr. **Saleh**. Or the institution; I believe that is true, yes.

Chairman **Ford**. Now, how could the Department of Education construe what we said in that interesting fashion? Excuse me.

Mr. **Saleh**. Mr. Chairman, we have contacted lenders and asked them specifically to not disburse or issue checks for first time borrowers until the 30th day of classes to ease our administration. We would get those checks in one lump, and we wouldn't have to hold them and sort them through, and we have been told by lenders that they can't do that; they are going to issue all the checks at the same time. So I believe the answer to your question is that they will all be issued at the same time, and that interest will start accruing immediately.

Mr. **Coleman**. Okay, that is one of your examples. Then you are suggesting that we should do away with the 30-day delayed disbursement for these low default institutions, and you would——

Mr. **Saleh**. I would apply—you may apply different tests for different regulations. My impression of the need for that regulation is that there are institutions that have students start and leave within 30 days. At an institution like ours we have far less than 1 percent of our students starting and leaving within 30 days so, frankly, I don't see the point in what impact it would have on an impact like ours.

Mr. **Coleman**. Mr. Belew, perhaps you might comment on the discovery we have just made concerning the interest charge for a check that everyone knows is going to be held for 30 days. Why might there be interest running on that check?

Mr. **Belew**. I regret I am not going to be able to. I am not familiar with that procedure. I believe the disbursement dates are available to the schools, but I will have to do a follow-up on that.

Mr. **Coleman**. Let me ask you, any other loans that you are familiar with as a banker, is there any other loan that is knowingly held by a client or somebody?

Mr. **Belew**. No, sir.

Mr. COLEMAN. This is unique?

Mr. BELEW. Not to my knowledge.

Mr. COLEMAN. As I recall, interest is a charge on the use of money.

Mr. BELEW. That principle applies——

Mr. COLEMAN. Is it being used while it is being held for 30 days? Who is using it?

Mr. BELEW. It seems to be in limbo. The standard practice throughout banking is the date of crediting to an account, usually the clock starts running, whether it is for interest being given to the customer or the other way around.

Mr. COLEMAN. Do you have to account for that on your books in some regulatory fashion?

Mr. BELEW. Yes, sir.

Mr. COLEMAN. Through a Federal examiner or something, so you have to, in prudent business sense, start the clock ticking for interest?

Mr. BELEW. You do. You have tight accounting rules as well as Federal regulations on consumer protection side as well. Short of that, I wouldn't want to wade into this any further because I think you need a more legal opinion on that.

Mr. COLEMAN. Okay. Is 1 percent your cut-off for this exemption, or 2 percent? Or do you have a——

Mr. SALEH. I would not advocate a 1 percent cut-off rate. I think that would likely exclude too many institutions and, frankly, Mr. Coleman, I am not sure what that rate should be.

One of the difficulties is that we calculate default rates differently for Stafford than we do for Perkins, but I would think that a rate of under 3 or 4 percent is going to begin giving you a very good look. That may be the point where we start, and it may be lower than that.

Mr. COLEMAN. Mr. Butts, if we went to a direct loan system, or even continue the present one, does it make sense to have multiple disbursements instead of one delayed disbursement of a check?

Mr. BUTTS. Well, the 30-day delay, I have to agree, is not a very useful approach to controlling defaults at low default institutions. Multiple disbursements like twice a year disbursements, absolutely, that is a good idea.

Mr. COLEMAN. Something like four, maybe?

Mr. BUTTS. It strikes me that again you need to look at the characteristics of the institutions. We have had multiple disbursements in the Perkins Loan Program from day one. You get a check at the beginning of the semester. It is credited to the student's account. If there are any refunds to it, that can be accommodated handily at the institution level.

Mr. COLEMAN. You don't see a big problem with that?

Mr. BUTTS. No. If you start talking about monthly disbursements, you want to do it four times a year in the course of traditional 8 month calendar, then without some cause then you are getting into sort of a micro-managing thing I would suggest be avoided.

Mr. COLEMAN. Well, the purpose is to reduce the default rates.

Mr. BUTTS. That is right. If you can show that it makes a significant contribution there, but in principle, yes, of course we support multiple disbursements.

Mr. SALEH. Mr. Coleman, if I may, I would agree with Mr. Butts that the multiple disbursements when we went to two disbursements really was a step in the right direction. It really helped. There are students attending traditional institutions who attend in the fall and don't come back in the spring, and I think that was a very good step.

I would suggest that if we were going to go to disbursements more frequently than that, it again would be performance based. If it is an institution with a high default rate, then let's talk about multiple disbursements.

Mr. COLEMAN. Perhaps under some sort of management plan with the department?

Mr. SALEH. Yes.

Mr. COLEMAN. Mr. Belew, do you have any serious problems with the multiple disbursements idea we were talking about?

Mr. BELEW. No, sir. We have worked with the committee and with the department in trying to improve those. We have endorsed various forms of multiple and delayed disbursements. We think the concerns were legitimate, and those were appropriate measures to take.

Mr. COLEMAN. Thank you.

Chairman FORD. I can't pass it up. You had Mr. Coleman and I, I think up in Philadelphia, where your association endorsed multiple disbursements, and it was the kind of multiple disbursements that your members were already making. We discovered during the last reauthorization process 5 years ago that many banks were writing more than one check for the proceeds of a maximum guaranteed student loan. One was written at the beginning when the loan instrument was signed, and one was written further down the road.

The interest meter clicked at the Department of Education as soon as the first one was written, and interest kept accumulating in the banker's account even though no disbursement had been made.

We reached out and said, "There will be multiple disbursements, but the interest clock won't start running until each of the multiples is actually disbursed."

At that time there was an estimate of several hundred million dollars afloat out there in this program between the money that we were paying in school interest on and the money that had been paid out, and it was working very well to the benefit of the people.

Now I discover this morning we wrote one more provision intended to save money and take credit for cutting the cost of this program without taking money away from kids, and you guys are getting a float again. Now it is only a 30-day float, but it is a pretty good sized float.

I am going to have to figure out what 30 days of money sitting in your vault or in your computer collecting interest from the Federal Government while your check hasn't been disbursed really means. That is not what we had in mind. Nobody in this room who was here when we did that believes it. We did it to cut the budget, to meet the crazy requirements that they gave us, and after we do it, somebody at the Department of Education now lets you cut a check at the day that the note is written, send it to Mr. Saleh, say, "Sit on this check for 30 days."

You know, I wish I could pay my bills by sending a check and say, "Don't cash this for 30 days." It is the old joke about the fellow that goes past the friend's coffin, and people are throwing money in to help him in the hereafter, and he says, "I'll take some change and write a check," and throws it in there.

You know, I don't think that anybody did this deliberately, but this is clearly not what we intended, and this has got to be cleaned up right away. This is not only bad from the point of view that you are talking about. I originally tried to get 60 days. What we started out to do, these premiere institutions like the ones at the table ought to remember, is respond to all the criticisms of the proprietary schools and the short term educational programs. And you know who was that complained to me when I said, "Sixty days?" The same kind of people who are at this table.

"That will inconvenience our bursar. When school starts, the bursar wants to know how much money we have got in our bank account, and we can't be waiting around for students for 30 days or 60 days to get their money. We want to be ready." When you get your tail into that seat in the classroom, it has got to be paid for.

It was the premiere institutions who couldn't be inconvenienced by 30 days. I have never been very much impressed, including Mr. Butts' university which is in my area, with the argument of inconvenience for that school.

But I am impressed with the fact that even when we impose the inconvenience, it is not doing what we said. It may be saving us a little on default, but the next question that comes to my mind, suppose the student isn't there at the end of 30 days, and the meter has been running in the meantime.

How do we get our money back? Yes, the interest that has accrued to the account of the lender. There is no checks exchanged for interest, is there? That goes on a computer account and it is like the loan origination fee. That simply goes into your account and becomes a credit to you, and you tell the government you have collected—you don't send a check to the government for the origination fee.

Mr. **Belew**. May I drop back one step to the original question because I am not at all certain that that interest is being charged for those 30 days.

Chairman **Ford**. Do you suppose you could find out and let us know?

Mr. **Belew**. Yes, sir. I will do that post haste because I don't want you to get upset about a problem that might not exist.

In point of fact, I believe there is a procedure by which the school can notify the lender of the exact date the check is needed, when it should be cut and counter-signed and so forth. But I would like to get a very clear answer to you for the record for this hearing, if I may.

Chairman **Ford**. While you are looking at it, find out which instrument triggers the computer. Is it the cashing of the check or is it the execution of the note?

Mr. **Belew**. I will do so.

Chairman **Ford**. Now, the way you fellows used to do it, it was on the execution of the note, and you disbursed some of the money at the end of 2 months and some of the money after another 2 months, and some of the money later but collected the interest during the whole period of time. We stopped that. We thought we did.

Now, I want to know whether this new one works that way or not.

Mr. BELEW. I will find out.

Mr. COLEMAN. Well, I would like to also, because apparently Cornell has these checks sitting around there for 30 days. You know; you have seen that?

Mr. SALEH. I am speaking into the future. I am predicting what will happen in this coming fall for that group of freshmen who enter in the fall.

Mr. COLEMAN. So we might be able to control this problem before it goes too far.

Mr. SALEH. I think that is possible. My understanding is the regulations on this have not been written yet so it may very well be possible.

Mr. COLEMAN. We will start writing them tonight.

Chairman FORD. We will have a joint letter, you and I, to the Secretary.

Mr. BELEW. Mr. Chairman, I would point out that with direct loans as with the other student aid programs, when the institutions draw the money down from the treasury, they can't take it down more than three days prior to actual disbursement and are prohibited from earning a float on any money they draw from the treasury.

Chairman FORD. Mr. Andrews?

Mr. ANDREWS. Thank you, Mr. Chairman. I want to thank each of the panelists for their very enlightening discussion, and I wanted to ask Father Whalen a question.

I understand that there are three major ways that the Federal Government assists or can assist students in loan programs. The first way is to directly subsidize their loan with current dollars, either by buying down the interest rate or paying the interest rate for a period of time.

The second way is by credit enhancement. That is to lend the full faith and credit of some public entity, presumably the Federal Government, to the loan transaction, which provides an incentive for the lender to provide a lower rate of interest and a lower cost of funds to the student.

And then the third way is to make a borrower or give a borrower access to the Federal Government's—what we might call discounted rate of acquiring funds; the fact that the Federal Government, because it borrows in such great bulk and has a relatively high credit rating, is able to acquire funds at a lower cost.

It is my understanding that your proposal involves only the second and third kinds of assistance; that your proposal would say that entities like the one that you have organized would have a limited guarantee, limited because it would have a deductible provision in it. The guarantee would not kick in until the 5 percent ceiling occurred, and then, secondly, you would look for a way that organizations such as yours could benefit from that third category of help which would be the lower cost of acquiring funds.

If we were to—first of all, I would like to know if that is an accurate summary of what you said.

Reverend **Whalen**. That is completely accurate.

Mr. **Andrews**. Okay. If we were to adopt your recommendations, what kind of impact would that have on a student who borrows, say, $5,000 from your program? Let's say I am going to attend the greatest university—one of the two greatest universities in America, Cornell University. I am going to borrow $5,000 to attend Cornell University.

What would these kind of credit enhancements do to my cost of borrowing that $5,000?

Reverend **Whalen**. It may reduce your cost of borrowing by someplace between a point and a point and a half, a percent and a percent and a half.

Mr. **Andrews**. On the rate of interest that I pay?

Reverend **Whalen**. On the rate of interest which you pay.

Mr. **Andrews**. Which presumably is somewhere, 10, 12, 13 percent?

Reverend **Whalen**. On cost of that interest. Currently, our rate of interest is about nine and a quarter so it would reduce it to in the neighborhood of 8 percent, and that would have a dramatic impact on the repayment, on the repayment schedule, the monthly payment schedule.

Mr. **Andrews**. Given the lower burden on the student when it comes time to repay the loan.

Under your program do students and their families service those loans on a current basis? Is there any deferral of interest or principal payment?

Reverend **Whalen**. They can choose to defer principal, but they have to begin to pay interest right away, and the reason for that is that we have to pay interest on our source of money right away.

Oddly enough, however, almost 50 percent of our borrowers choose to pay both principal and interest at the same time. They choose not to defer principal.

Mr. **Andrews**. How many families are taking advantage of your program right now?

Reverend **Whalen**. Currently about 31,000.

Mr. **Andrews**. How many applicants have you had over the course of your program?

Reverend **Whalen**. About 50,000, probably.

Mr. **Andrews**. And you screen the applicants on the basis of creditworthiness?

Reverend **Whalen**. Yes. We have 161 criteria that are looked at.

Mr. **Andrews**. That is more than you get when you run for Congress.

Reverend **Whalen**. For every application. These are all computerized. There is no bank officer that looks at the loan application. It is a one-page application for the borrower, but the computer looks at it in 161 different ways, and everyone is treated equally, without any human intervention in this process whatsoever.

Mr. **Andrews**. I assume that if these reforms that you have proposed today were adopted, that a greater percentage of those applicants would become creditworthy because of the lower cost of the credit. Could you give us any kind of estimate as to how many more people would have been helped out of that applicant pool if these proposals were enacted?

Reverend Whalen. One of our criteria is the debt to income ratio.

Mr. Andrews. Right.

Reverend Whalen. So that the repayment of this loan, if it had a lower monthly repayment, would qualify, I would guess, 15 to 20 percent of those that we now don't make loans to would qualify for them.

Mr. Andrews. Thank you, Father. Mr. Belew, on page two of your written statement, the very last word on page two, you begin by saying, "Because Federal funds are less expensive to borrow than private sector funds, this"—and you are referring to the conceptual proposals for direct lending by the Federal Government—"this appears as a significant Federal capital savings."

What is your estimate of how much of a significant Federal capital savings would occur in terms of basis points?

Mr. Belew. It would be a significant number. I don't know the number of basis points. You would have to do some quick math, but I don't think anyone is contesting that Federal funds borrowing is going to be a cheaper source of funds.

We are simply looking at the other aspects of the program which might be more costly under the direct lending proposal.

Mr. Andrews. Well, can you give us an estimate of how much the Federal capital savings would be, just ballpark estimate?

Mr. Belew. A hundred basis points.

Mr. Andrews. Okay, and let's talk now about some of the increased expenditures that you talk about in your testimony, and I do sympathize, as the Chairman pointed out, I sympathize with your plight of having to analyze or critique a proposal that doesn't exist, and I hope that if the department is interested in this, they give us something tangible to explore, all of us something tangible to explore.

Some of the concerns that you raise, I guess they fall into two categories. One is the sort of increased cost of administering the program that goes to direct lending, and the second category is what you might call the opportunity cost, or the lost opportunity cost, that if people get out of the guarantee or lending market and there is a need to bring them back in later on, they either may not go back in, or it may be so expensive to bring them back in that you are going to cripple or undercut the program.

In the first category the increased present cost, what is wrong with this argument? The private sector efficiencies that presumably exist today by the private banking administration of the program could simply be replicated under this system if the department contracted out to the lowest responsible bidder the responsibility of administering the funds and servicing the loans.

Therefore, all of the private sector efficiencies that purportedly exist today would be replicated. What is wrong with that argument?

Mr. Belew. Well, there are two levels of the efficiencies which exist now. One is in the private sector lending, servicing community, and then in the guaranty agencies, but let's look at the lenders.

It is unclear to us how many of the lenders would want to remain in as servicers. Now, it is conceivable you would find companies who are doing servicing now who would simply want to contract with the government.

I can't answer that question because it is very much of an intangible. It may be that there would be companies that wanted to remain as players. It may be that many would want to take a walk. Certainly from a lender perspective there are any number of functions that occur within the lending community, and to the extent that the lenders decide to exit the program, they have the investment of hardware, software, and people skills which are going to have to be phased out. That would take a significant investment to rebuild at a later time if that became necessary.

Mr. ANDREWS. Well, do the lenders make a profit, as a rule, on the servicing activities?

Mr. BELEW. It depends from company to company, again. There is a certain amount of profit in the lending aspect, and then you have companies which do nothing but servicing, so the servicing aspect is usually on a fee base so under your scenario there could be a servicing company just contracted out for a fee, assumedly a higher fee than currently if they are asked to share the burden of defaults, so there is another very difficult cost factor to estimate in terms of a higher fee arrangement which would have to be built in for a servicer if they were partially liable.

Mr. ANDREWS. Another point that I think I understand that you make is the elimination of the guarantee agencies would shift the entire risk of default to the Federal Government, eliminating the situation we have now where a guarantee agency improperly reports or monitors a loan and therefore eats the loan, or therefore must absorb that loss. How frequent is that? It seems to me that a well managed bank, lender, or guarantee agency simply has to comply with the 30 day kinds of notice requirements, and if it does so, it doesn't absorb the cost of the loan?

Let me put it to you this way. Of the volume of dollars of defaulted loans in the country, what percentage wound up getting absorbed by either the guarantee agency or the lender because they have failed to comply with the requirements of the law?

Mr. BELEW. I believe I saw a figure of $400 million over the last 2 years so $200 million per annum.

Mr. ANDREWS. It may be less than 10 percent, the dollar volume, since we had $2.5 billion, right?

Mr. BELEW. There may be a larger question, Congressman, and that is how well default prevention might work if the guarantee mechanism were removed because currently you have the lender mechanisms and then the guarantee agency mechanisms in lock step through the procedures, both of which try to go through the collections and to partially cure default.

You might lose a large part of that if you assume it all is lodged in the department under a direct proposal, and you may not have as efficient a collection mechanism and recoveries.

Mr. ANDREWS. Well, that presupposes that there isn't an adequate incentive for someone to make a profit by giving us that effective collection mechanism, and that is a question that is debatable.

Let me just close with this point, and I think you make the point persuasively, that we are testing an unknown versus a known, and I find it exceedingly attractive, intuitively attractive, that we can go to the existing dollars in this program, and on the basis of a spread of 80 to 120 basis point differential in the cost of acquiring funds, either broaden the accessibility of this program to many people who are not in it, or increase what we do for those who are already in it, or do what we are doing now at a lower cost for those who are in there. I mean, it provides a lot of very happy options for us, and your point to that is, "Well, we don't really know how this would work in the real world because it hasn't been tested in the marketplace."

I understand that. What is your proposal as to what we do, though? I mean, what is the conclusion of that argument? When I read your testimony, you say a lot of unanswered questions, even on a conceptual level. You are right; I agree. What is the "therefore?" Is it, "Therefore, we shouldn't do this at all?" Or, "Therefore, we should experiment with it on a pilot basis?" What should we do when we are confronted with an intuitively attractive idea like this?

Mr. **Belew**. Well, I think the first thing, it is difficult to say whether it is truly attractive until you find out if that is real money, the 80 to 120 basis points. Well, it may not be. That is in the cost of funding. There may be offsetting additional costs which wipe out or exceed that amount.

Mr. **Andrews**. How are we going to——

Mr. **Belew**. We don't know that, and I wish I had the numbers here.

Mr. **Andrews**. Well, how are we going to find that out?

Mr. **Belew**. I think the OMB and the department will be working on that, as I understand, and we eagerly await those as well.

Mr. **Andrews**. Hopefully, they get the data bank finished first, and then do that. Okay.

Mr. **Belew**. I really don't mean to dodge the question, but it is very difficult to say just how real that money is. In terms of what we are suggesting, we have submitted on several occasions our proposed improvements in the Stafford program which we hope will be taken into account through the reauthorization process.

Mr. **Andrews**. But those proposals really do not—I mean, they assume the continued existence of the private lender guarantee model and don't give us an opportunity to try this one out. How should we try this one out? Should we, or shouldn't we?

Mr. **Belew**. I think the first step, obviously, is to take a look at those cost estimates to see whether you still intuitively believe that it is attractive.

Mr. **Andrews**. Thank you, and I will close with this point, that I guess there is two ways you can find that out. One is to commission a study, which I think is going to come back and say pretty much what this dialogue has said today, is that there is one argument that the market will react this way, and that there will be an incentive for people to get in and service these loans, and in fact the public will get almost the full benefit of the interest rate differential because the administrative costs will be pretty much awash.

There is another argument that will say, "No, the market will react very differently, and the increased or the changed risk allocation and the inefficiencies in servicing will wipe out the interest rate differential, and you are not going to save any money at all."

I could write an econometric model that would probably prove one or the other.

It seems to me the other way to go about this is try it on some kind of fair test basis where in the real market and the real world we could find out if this happens, and I guess I would encourage everyone here to advise us as to ways we might do that in a way that is fair and rational.

Thank you very much.

Chairman Ford. Mr. Petri?

Mr. Petri. Thank you, Mr. Chairman. First of all, I just wanted to thank each and every one of the witnesses for your testimony and tell you how much I appreciate the effort that you have made to develop a direct loan program. It is something that has interested me for a long time, and I am looking forward as we move to the writing of this legislation to working with you in trying to come up with something that is feasible and that will help solve a number of problems and fill some gaps that we have got.

Reverend Whalen, you said we ought to come up with a good name for our program. I have a modest proposal, if we do have a direct loan program. We might call it the Ford Program in honor of a fellow who has spent more years on this subject and done more, I think, than anyone else in the House, certainly during the time I have served in the House of Representatives.

Some say we need to have a model program or see if it will work in the real world. I am particularly impressed that you haven't waited for someone else to do that. You have, in fact, done a model program without any government support or help, and helped 30,000 families and loaned several hundreds of millions of dollars to them so we know that there is a need there, and we know it can be done. The only real question is whether we can contribute in improving access to a lot of middle income families who are falling between the cracks or if we will end up futzing things up which the Federal Government sometimes does with the best of intentions.

I guess I do have a couple of questions. One is of you, Mr. Butts, particularly, and maybe Mr. Saleh. That is whether there is any interest at all in the higher education community in trying to solve the default problem by having, or giving the option to an institution, of co-signing all or a portion of loans that its students get in exchange for streamlining the system; in other words, getting rid of a lot of these requirements so far as screening and bureaucratic delay and everything else, and giving that institution some of the money. If an institution's loan default rate is below a percent and a half, say, the institution could keep the funds, and if it was over a percent and a half the institution would have to pay all or a portion of the defaults.

We do this sort of thing with federally insured, small business loans and with other federally insured loans, so it is not a foreign concept, and I just wonder if you think there is any interest in exploring something like that to simplify guaranteed student loans and to cut away a lot of the paper work which is really not necessary.

Mr. **Butts**. There hasn't been a lot of discussion, I don't believe, in the higher education community of late on concepts of that sort. There is a precedent with the Perkins Loan Program, of course, where the institutions have a one-ninth match requirement which puts them at risk to some extent in the default areas.

Certainly as you consider notions of this sort, you want to see where it might truly help or whether it is simply another thing that might add to the complexity of the process.

Clearly, the entire community wants to minimize defaults, and whatever can be done reasonably in that area must be done. With direct lending you do have much clearer lines of accountability than I think you have at the moment with the more diffuse guarantee type system. You know where the money comes from, whether the institutions get it. It goes to the students; a clear track of responsibility in terms of collection done under servicing contracts with the department. When there is a problem, you know exactly who to have at the table here.

That is not the case in the current situation. Though that type of notion needs to be traded off against the idea of a one-ninth match or other approaches as you describe.

Mr. **Saleh**. I am going to have a little difficulty answering the question because your idea is one that at an institution like Cornell we can think about, and at institutions represented by State university systems, the legislature can think about that.

So if the question were directed at institutions, as the Chairman pointed out, that have strong financial positions, then it is certainly something that we can think about, and we understand that there is a risk to be taken here by some party. Truly our students and our institutions benefit from these programs.

The concern I have is that there are a number of schools out there in the proprietary sector and in the independent sector that run much closer to the margin, and this would be a very difficult issue for them.

I guess my answer is similar to Tom's that we have precedent in the Perkins Loan Program. Most institutions, I think, are very willing—institutions like ours are very willing to put in our one-ninth match and assume the responsibility. We do our own collections. We don't ask someone else to do them and have a good track record with that, and we understand the liability when we make a loan of our own moneys.

So I think there is good reason to consider what you are suggesting.

Mr. **Petri**. Okay, then, just one general question of anyone who would care to respond, although I think Reverend Whalen may be the most likely candidate. I have introduced the IDEA version of a direct loan program, and I would appreciate any advice or suggestions or reactions or criticisms or improvements that you might have with regard to that.

Reverend **Whalen**. I don't think I am in the position today, Mr. Petri, to respond to that. I have an appointment, I think, set up with your staff, however, to go over it with them. I think it is an intriguing idea. I think it has a great deal of merit to it, but to get into the specifics, I really didn't come prepared to do that today.

Ms. **Smith**. If I could comment, we have also been in communication with Mr. Flader and plan to have him come down and discuss the proposal in more detail with the associations there in our building at One DuPont Circle.

We have certainly enjoyed the conversations in the past and respect a great deal all the work he has done on really trying to make income contingency something reasonable and not onerous.

Mr. **Saleh**. Mr. Petri, I guess the comment I was wanting to make about the direct lending program when Mr. Andrews was asking the question, too, deals with the idea of having a parallel program or a pilot program in the early stages, and the good sense that that may make for all of us.

It seems to me that if we were to select institutions and to run the program on an optional basis in the early years, we could deal with a number of the issues that are unanswered at this point.

One suggestion made was that there is a $20 per applicant or per recipient administrative allowance to the institutions, and I may risk the wrath of my colleagues in saying that I am not sure that that is really necessary. I think running a program in the early years would allow us to judge that.

Institutions, frankly, have something to be gained in this program. There is administrative gain. If you take a look at our institution, we handle 15,000 checks per year. There is a significant cost in handling those checks, having students come in and sign them, depositing them, accounting for them. A direct lending program would allow the funds to move electronically to students' accounts. We would still have to have promissory notes signed, but the checks would not have to be handled.

It would also deal with the issue of float that we talked about earlier. We would, instead of having checks sit in cashiers' offices for sometimes weeks waiting for students to come in and sign them, we would deposit them to the students' accounts, immediately funds to the accounts, and thereby pay the tuition early on.

So the institution gains the float on the money where now the lenders had the float on the money. So I think one of the things, not wanting to use the word "study" but I will, one of the things that we would study is whether the institutions gain enough in reduced administrative charges from this kind of program that it warrants no administrative allowance for running the program, and I think that could be done. That could be understood by running the program as an optional program in the early years.

Chairman **Ford**. I want to thank the panel for a very interesting discussion today.

I am not very optimistic that anything has been done with these changes that we have made in the ensuing period of time. I am impressed with the fact that there is a bit of fraud on our part. We have been given credit by the Congressional Budget Office year after year for saving money, and then the Department of Education hasn't done anything to save the money so no money has been saved but we have got the credit. It is a great system. It makes the budget look good; it makes us look good, but we are getting a letter off to the Secretary to ask if we can't get up to date.

The committee stands adjourned.

[Whereupon, at 12 noon, the subcommittee was adjourned subject to the call of the Chair.]

[Additional material submitted for the record follows.]

STATEMENT OF HON. THOMAS C. SAWYER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Thank you, Mr. Chairman, for making it possible for this subcommittee to continue to examine the Stafford Loan program.

The Higher Education Act authorizes nearly $20 billion in student financial aid.

By far the largest part of that aid is in the form of Stafford loans, which accounted for $12.3 billion in the 1989-90 school year.

This program also accounts for the largest amount of criticism in the Higher Education Act.

The Senate Permanent Subcommittee on Investigations recently issued a report that described the Guaranteed Student Loan Program as "riddled with fraud, waste, abuse and pervasive patterns of mismanagement."

Everyone is worried by the high rate of defaults.

And many of us are concerned that working class and middle income families lack access to these loans.

But the same program that has prompted so many concerns has also given millions of students access to higher education that they never would have received without Stafford loans.

Does this program need radical changes or moderate reforms?

Should it be completely eliminated?

I look forward to hearing the alternatives that the witnesses will present to us.

HEARING ON THE REAUTHORIZATION OF THE HIGHER EDUCATION ACT OF 1965

WEDNESDAY, JUNE 19, 1991

House of Representatives,
Subcommittee on Postsecondary Education,
Committee on Education and Labor,
Washington, DC.

The subcommittee met, pursuant to call, at 9:46 a.m., Room 2175, Rayburn House Office Building, Hon. William D. Ford [Chairman] presiding.

Members present: Representatives Ford, Williams, Hayes, Lowey, Sawyer, Andrews, Reed, Kildee, Murphy, Coleman, Klug, Goodling, and Gunderson.

Staff present: Thomas Wolanin, staff director; Jack Jennings, education counsel; Maureen Long, legislative associate; Gloria Gray-Watson, administrative assistant; Rose DiNapoli, minority professional staff member; and Jo-Marie St. Martin, minority education counsel.

Chairman Ford. This morning we convene the Subcommittee on Postsecondary Education for this the 25th of 46 hearings scheduled on reauthorization.

Today's hearing is our third in a series of three on the Stafford Loan Program. About $4.2 billion in Federal funding generates about $12 billion in Stafford loans for almost 4 million students and their parents each year.

Today I am pleased that Representative Tim Penny from Minnesota is appearing before us to discuss his bill, H.R. 179, which would restore a deferment on repayment of student loans for borrowers in a postgraduate internship or residency program. Mr. Penny is very familiar with the Federal student aid program, having been a member of this subcommittee during the last reauthorization of this Act.

I am pleased to welcome Representative Clay Shaw from Florida, who will testify regarding his bill, H.R. 709, which would provide reduced rates of interest to Stafford borrowers who enter the teaching profession.

Our second panel today focuses on the subject of government-sponsored enterprises, referred to around here as GSEs. The Omnibus Reconciliation Act of 1990 required the Department of Treasury and the Congressional Budget Office to submit to Congress a report on government-sponsored enterprises. The 1990 Reconciliation also required each committee that had jurisdiction over a GSE to report legislation by September 15, 1991, to ensure the financial soundness of the GSE within their jurisdiction.

The Higher Education Act is the authorizing statute for one such GSE, the Student Loan Marketing Association. Today we will have before us representatives from the Department of the Treasury, the Congressional Budget Office, the General Accounting Office, which also did a study on GSEs, and the Student Loan Marketing Association, to discuss proposals to ensure the financial soundness of Sallie Mae, or the Student Loan Marketing Association. I look forward to hearing from all the witnesses.

Before we get to the witnesses, I will recognize Mr. Coleman.

Mr. **Coleman**. Mr. Chairman, I have no opening statement. I welcome our colleagues this morning and look forward to their testimony. Thank you.

Chairman **Ford**. Mr. Murphy has joined us this morning and has an opening statement.

Mr. **Murphy**. Thank you, Mr. Chairman. It is a pleasure to join you on your energetic set of hearings concerning the Reauthorization of the Higher Education Act. I appreciate the opportunity to participate in this hearing this morning.

It is my understanding that our colleague, Mr. Penny, will be discussing his bill, H.R. 179. I have also introduced a measure, H.R. 1482, the Resident Physician Student Loan Deferment Act, which is very similar in concept to Mr. Penny's legislation. My bill would allow physicians continuing their education in accredited residency training programs to defer payment of their Title IV student loans until completion of their residency program.

I believe that Mr. Penny's bill would also extend this exemption to a larger group of health professionals. As evidenced by the number of combined cosponsors of both of these measures, which is at least 150 at present, there is broad-based support in Congress for considering this type of legislation.

Current law now has the effect of accelerating the repayment of these loans at precisely the time that these graduate students are least able to meet such financial obligations due to postgraduate training. A 1 or 2 year residency, the length of time student deferment is allowed under current law, does not allow sufficient time for certification in any specialized area. The present law can have the effect, therefore, of discouraging physicians from undergoing specialized training.

The cost of a medical education requires most medical students to borrow heavily to finance their education. The average debt is over $42,000. Many potential medical students are rethinking their careers. In addition, the indebtedness can make it financially impossible for young doctors to set up practice in rural or urban underserved areas. A longer deferment period for repaying these student loans will eliminate one factor contributing to the problem of specialty and geographic distribution of our physicians.

There are many other reasons for considering this type of legislation, which I am sure Mr. Penny will elaborate on, and I would ask the committee to give this matter the attention it deserves.

Thank you, Mr. Chairman.

[The text of H.R. 1482 follows.]

102D CONGRESS
1ST SESSION

H. R. 1482

To amend title IV of the Higher Education Act of 1965 to allow resident physicians to defer repayment of title IV student loans while completing accredited resident training programs.

IN THE HOUSE OF REPRESENTATIVES

MARCH 19, 1991

Mr. MURPHY (for himself, Mr. HORTON, Mr. COLEMAN of Texas, Mr. YATRON, Mr. BEREUTER, Mr. PENNY, Mr. LENT, Mr. EVANS, Mr. TOWNS, Mr. HYDE, Mr. DERRICK, Mr. FROST, Mr. LANCASTER, Mr. RAMSTAD, Mr. BRUCE, Mr. LAGOMARSINO, Mr. ROE, Mr. OWENS of Utah, Mr. ERDREICH, Mr. CHAPMAN, and Ms. NORTON) introduced the following bill; which was referred to the Committee on Education and Labor

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A BILL

To amend title IV of the Higher Education Act of 1965 to allow resident physicians to defer repayment of title IV student loans while completing accredited resident training programs.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Resident Physician Student Loan Deferment Act".

SEC. 2. RESIDENT PHYSICIAN DEFERMENTS.

(a) FEDERALLY INSURED STUDENT LOANS.—Section 427(a)(2)(C)(i) of the Higher Education Act of 1965 (20 U.S.C. 1077(a)(2)(C)(i)) is amended—

(1) by striking "or" before subclause (III);

(2) by striking "except" and all that follows through "residency program"; and

(3) by inserting before the semicolon at the end the following: "or (IV) is serving in a medical internship or residency program accredited by the Accreditation Council for Graduate Medical Education or the Accrediting Committee of the American Osteopathic Association".

(b) FEDERAL PAYMENTS TO REDUCE STUDENT INTEREST COSTS.—Section 428(b)(1)(M)(i) of the Act (20 U.S.C. 1078(b)(1)(M)(i)) is amended—

(1) by striking "or" before subclause (III);

(2) by striking "except" and all that follows through "residency program"; and

(3) by inserting before the semicolon at the end the following: "or (IV) is serving in a medical internship or residency program accredited by the Accreditation Council for Graduate Medical Education or the Accrediting Committee of the American Osteopathic Association".

(c) LOAN AGREEMENTS.—Section 464(c)(2)(A)(i) of the Act (20 U.S.C. 1087dd(c)(2)(A)(i)) is amended—

(1) by striking "except" and all that follows through "residency program"; and

(2) by inserting before the semicolon at the end the following: "or serving in a medical internship or residency program accredited by the Accreditation Council for Graduate Medical Education or the Accrediting Committee of the American Osteopathic Association".

(d) EFFECTIVE DATE.—The amendments made by this Act shall apply to any loan made, insured, or guaranteed under part B or part E of title IV of the Higher Education Act of 1965 (20 U.S.C. 1071 et seq. and 1087aa et seq.), including a loan made before the date of enactment of this Act.

Chairman Ford. Mr. Klug.

Mr. Klug. Thank you, Mr. Chairman. I just have a brief statement.

I would like to welcome Congressmen Penny and Shaw here today. We in Congress have for years provided tax incentives to help both individuals and companies funnel savings into plans where we thought it was in the common good, such as home ownership. It seems to me only to make sense that we try to do the same kind of thinking and planning and execute the same kinds of ideas when it comes to education.

Clearly, Mr. Chairman, as you know, there is a great need in this country for people interested in science, doing whatever we can to encourage more people to enter medicine, and also to have folks enter the teaching profession. Those are some of the ideas that we are going to talk about on the panel today, from Mr. Shaw and Mr. Penny.

In the near future, I will be introducing legislation to provide incentives for college graduates interested in teaching to serve the very special needs of disabled infants and toddlers. There is a program now which includes the ages three to five, but, because of the new birth through three program, we are going to try to close the present loophole.

So, again, in closing, let me welcome my colleagues and continue to praise you for holding these hearings.

[The prepared statement of Hon. Scott Klug follows:]

Statement of Hon. Scott Klug, a Representative in Congress from the State of Wisconsin

Thank you, Mr. Chairman. I'd like to join the other members of the committee in welcoming our distinguished colleague from the other body, Senator Bumpers, and Congressmen Penny and Clay.

We routinely, and very appropriately, use the tax code to encourage individual decisions and behavior which we believe will serve the common good. We try to encourage home ownership, saving, investment, and many other things which are not only good for the individual, but for the community at large.

It is perfectly appropriate that we also consider ways to create similar incentives in the structure of our student financial aid programs, as our colleagues on this panel are proposing that we do.

Clearly, Mr. Chairman, there are many vitally important areas—in the teaching professions and the sciences, for example-in need of talented and committed people. We need to encourage more of our college educated and trained men and women to focus their energies and make their careers in these and other areas.

I commend all three of our colleagues for the very interesting proposals that they've put forward, and I will in fact be introducing legislation which will use this same mechanism to increase the incentives for college graduates interested in teaching to serve the very special needs of disabled infants and toddlers.

In closing let me again welcome our colleagues. I look forward to their testimony.

Chairman Ford. Mr. Reed.

Mr. Reed. Thank you, Mr. Chairman. I would just like to welcome my colleagues, Mr. Penny and Mr. Shaw, and I look forward to their testimony.

Chairman Ford. Mr. Goodling.

Mr. Goodling. Nothing, Mr. Chairman.

Chairman Ford. Mr. Sawyer.

Mr. Sawyer. Nothing, Mr. Chairman.

Chairman Ford. Without objection, the prepared statements of these witnesses and the panel following them will be inserted in the record immediately following the oral statement of each of the people who testify.

Further, without objection, is a statement of the Association of American Medical Colleges submitted for the record on this hearing by the Association of American Medical Colleges.

Mr. Penny, do you wish to proceed with your bill first?

STATEMENT OF THE HONORABLE TIMOTHY J. PENNY, A REPRESENTATIVE IN CONGRESS FORM THE STATE OF MINNESOTA

Mr. **Penny**. Thank you, Mr. Chairman.

I do appreciate the opportunity to testify before your committee this morning on my legislation, H.R. 179. As you know, this bill calls for deferment on repayment of federally-insured student loans during professional internships and residencies. This legislation currently has 130 cosponsors and is similar to legislation introduced in the other body by Senator Cohen, and that same legislation has been introduced here in the House by your colleague and mine, Representative Austin Murphy.

The legislation is necessitated by changes in the Reconciliation Act of 1989. That legislation restricted deferments on professional residencies or internships to no more than 2 years. As a consequence, even with forbearance, which could exist for another year beyond that, we are finding students with several years' worth of residency or internship at a very low stipend, who are expected to pay back a sizeable amount each month on their loans.

The residencies often last as much as 5, 6, or 7 years. Under current law, these students only have deferral on the first 2 years, and that places a financial hardship on them.

There is a growing debt burden among our professional students. Eighty-one percent of the 1989 graduates of medical schools were indebted. The average indebtedness was over $42,000, and 29 percent of that graduating class had debts in excess of $50,000. Even more alarming statistics exist for osteopathic schools, where the average debt was approximately $67,000, and 64 percent of those graduates in 1989 from that type of institution, or that type of program, had debts in excess of $50,000.

In addition, dental schools have average debt of $43,000, and 32 percent of the graduating class in a recent year had debts in excess of $50,000. So the indebtedness levels of these students is growing, and it is particularly evident among minority graduates more so than graduates as a whole.

The legislation I have introduced would ensure that a borrower can defer repayment for the duration of their internship or residency. Without this deferment, I fear that many medical students will opt for specialties with short residency periods or forego additional training entirely. This view is shared by many in the medical field. The American Medical Association, the Association of American Medical Colleges, and numerous other medical and professional organizations have all endorsed this legislation.

Representing a rural area, I am concerned that many medical students who might otherwise relocate to a rural area will instead opt for higher-paying residencies in urban areas unless the current limited deferment period is extended. Many small cities across the

United States lack basic medical care and have trouble attracting physicians. I believe the policy on loan deferment is one factor that will continue to exacerbate the rural health crisis.

Again, I look forward to working with the committee on this issue and would ask your indulgence to touch on one other issue involving legislation that I will soon introduce. I am talking about the nontraditional students, or what we call nontraditional students. The traditional image of an undergraduate is a 20-year-old, full-time student, who lives in the dorm for 4 years, and then graduates. But today that represents only about 20 percent of the students on our college campuses.

A more accurate picture today is a 25-year-old female who lives off campus, works almost full time, and commutes to a community college. This individual postpones having children until earning a degree, or juggles both family and school. Of the approximately 13 million college students, 55 percent today are female; 45 percent are at least 24 years old; 40 percent attend school part-time; and nearly 30 percent are married.

The number of part-time students is expected to grow to 60 percent by the year 1995, and not all part-time students are older students. Twenty percent of students under age 24 also attend school on a part-time basis at present.

Despite the trend toward attending school on a less than half-time basis, only 6 percent of these students receive Pell grants presently. In 1989, in his report to Congress on less-than-half-time students, former Secretary of Education Cavazos concluded, "Such students deserve our encouragement support and should not be denied access to training that may better their job skills or employment solely because they are unable to enroll for more than a few courses at a time."

At the same time, these nontraditional students are not eligible for any federally-insured student loans. Many of these students have no access to any form of student aid at all. My legislation is aimed at helping these students by allowing them access to the guaranteed student loan program and the grant program, based on their financial need and their resources, and not on their enrollment status as full or part time.

Mr. Chairman, as Congress begins to process the reauthorization bill, I would hope that we would keep in mind these changes on our college campuses, and I would ask at this point unanimous consent to include in the record letters of support for the medical school deferment bill from the American Medical Association, from the Organization of Student Representatives of the American Association of Medical Colleges, a letter of support from the American Association of Dental Schools, a letter of support from the Mayo Clinic in my district, and two articles, one from JAMA and one from AMN.

I have several letters and two articles in support of the deferment bill that I would like included in the record.

Chairman **Ford**. Without objection, so ordered.

[The prepared statement of Hon. Timothy J. Penny follows:]

STATEMENT OF CONGRESSMAN TIMOTHY J. PENNY
JUNE 19, 1991

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, IT IS A PLEASURE TO APPEAR BEFORE THE SUBCOMMITTEE IN SUPPORT OF MY LEGISLATION, H.R. 179, THAT WOULD ALLOW A DEFERMENT FROM REPAYMENT OF FEDERALLY-INSURED STUDENT LOANS DURING PROFESSIONAL INTERNSHIPS AND RESIDENCIES. THIS LEGISLATION CURRENTLY HAS NEARLY 130 COSPONSORS IN THE HOUSE. SIMILAR LEGISLATION HAS BEEN INTRODUCED IN THE OTHER BODY BY SENATOR WILLIAM COHEN OF MAINE AND OUR COLLEAGUE REPRESENTATIVE AUSTIN MURPHY HAS AUTHORED THE COMPANION TO THE COHEN BILL IN THE HOUSE.

MY LEGISLATION IS NECESSITATED BY CHANGES MADE IN THE OMNIBUS BUDGET RECONCILIATION ACT OF 1989 (P.L. 101-239) IN THE DEFERMENT PROVISIONS OF TITLE IV OF THE HIGHER EDUCATION ACT. THAT LEGISLATION PROHIBITED MEDICAL RESIDENTS FROM BEING CLASSIFIED AS STUDENTS FOR THE PURPOSE OF DEFERMENT OF THEIR LOAN REPAYMENT. AS OF JANUARY 1, 1990, MEDICAL RESIDENTS AND OTHER STUDENTS ENGAGED IN PROFESSIONAL INTERNSHIPS OR RESIDENCIES WILL BE ELIGIBLE FOR DEFERMENT OF STAFFORD, SLS, AND PERKINS LOANS FOR A PERIOD OF ONLY TWO YEARS. WHILE A MANDATED FORBEARANCE PROVISION WAS AGREED TO IN THE RECONCILIATION ACT THAT WILL ALLOW A BORROWER THE PRIVILEGE OF DELAYING REPAYMENT AND CAPITALIZING THE ADDED INTEREST COSTS, MEDICAL INTERNSHIPS AND RESIDENCIES CAN TYPICALLY LAST FOR THREE TO SEVEN YEARS. UNDER CURRENT LAW, ONCE A BORROWER HAS EXHAUSTED HIS OR HER DEFERMENT AND FORBEARANCE, REPAYMENT MUST BEGIN. ON A MODEST STIPEND, THE AVERAGE DOCTOR-IN-TRAINING CANNOT AFFORD A LOAN PAYMENT OF $600 OR MORE PER MONTH.

THE GROWING DEBT BURDEN OF PROFESSIONAL STUDENTS, PARTICULARLY MEDICAL DOCTORS, HAS REACHED UNPRECEDENTED LEVELS. EIGHTY-ONE PERCENT OF 1989 GRADUATES OF MEDICAL SCHOOL WERE INDEBTED; THE AVERAGE DEBT OF THESE GRADUATES AMOUNTED TO $42,374; 29 PERCENT OF THIS GRADUATING CLASS HAD

DEBTS IN EXCESS OF $50,000. NINETY-FIVE PERCENT OF 1989 GRADUATES OF OSTEOPATHIC MEDICAL SCHOOLS WERE INDEBTED; THE AVERAGE DEBT OF THESE GRADUATES WAS APPROXIMATELY $67,000; 64 PERCENT OF THE 1989 GRADUATING CLASS HAD DEBTS IN EXCESS OF $50,000 AND 20 PERCENT HAD DEBTS EXCEEDING $100,000. FINALLY, 89 PERCENT OF 1989 GRADUATES OF DENTAL SCHOOLS WERE INDEBTED; THE AVERAGE DEBT OF THESE GRADUATES WAS $43,300; 32 PERCENT OF THIS GRADUATING CLASS HAD DEBTS IN EXCESS OF $50,000.

FURTHERMORE, THE EDUCATIONAL INDEBTEDNESS LEVELS OF UNDERREPRESENTED MINORITY GRADUATES ARE EVEN GREATER THAN THEY ARE AMONG INDEBTED GRADUATES AS A WHOLE. THE AVERAGE DEBT OF 1988 UNDERREPRESENTED MINORITY MEDICAL SCHOOL GRADUATES WAS $44,897--$6,408 ABOVE THE MEAN FOR ALL INDEBTED GRADUATES THAT YEAR.

THE LEGISLATION I HAVE INTRODUCED WILL INSURE THAT A BORROWER CAN DEFER REPAYMENT FOR THE DURATION OF THE INTERNSHIP/ RESIDENCY TRAINING PERIOD. WITHOUT THIS GRANT OF DEFERMENT, I FEAR MANY MEDICAL STUDENTS WILL OPT FOR SPECIALTIES WITH SHORT RESIDENCY PERIODS OR FORGO ADDITIONAL TRAINING. THIS VIEW IS SHARED BY THE AMERICAN MEDICAL ASSOCIATION, THE ASSOCIATION OF AMERICAN MEDICAL COLLEGES, AND NUMEROUS OTHER MEDICAL AND PROFESSIONAL ORGANIZATIONS ALL OF WHOM ENDORSE THIS BILL. I HAVE ALSO RECEIVED LETTERS OF ENDORSEMENT FROM HUNDREDS OF MEDICAL AND PROFESSIONAL STUDENTS FROM AROUND THE NATION.

REPRESENTING A RURAL AREA I AM CONCERNED THAT MANY MEDICAL STUDENTS WHO MIGHT OTHERWISE RELOCATE TO RURAL AMERICA WILL INSTEAD OPT FOR HIGHER PAYING RESIDENCIES IN URBAN AREAS UNLESS THE CURRENT LIMITED DEFERMENT PERIOD IS EXTENDED. MANY SMALL CITIES ACROSS THE COUNTRY CANNOT EVEN ATTRACT A SINGLE DOCTOR. MANY RURAL HOSPITALS CANNOT FIND PHYSICIANS IN CERTAIN SPECIALTIES. UNLESS WE CHANGE CURRENT LAW, AN ALREADY SIGNIFICANT RURAL HEALTH CARE CRISIS WILL BE EXACERBATED.

I WILL BE HAPPY TO WORK WITH THE COMMITTEE ON THIS ISSUE. AT A MINIMUM, PERHAPS WE CAN EXTEND THE DEFERMENT FOR AN ADDITIONAL YEAR.

LET ME DIGRESS A MOMENT MR. CHAIRMAN TO BRIEFLY COMMENT ON ANOTHER SET OF CONCERNS I HAVE SHARED WITH YOU RECENTLY: THE NEED TO PROVIDE AID TO NON-TRADITIONAL STUDENTS.

IN THE NEXT FEW DAYS I INTEND TO INTRODUCE LEGISLATION ONCE AGAIN TO MAKE ALL STUDENTS ELIGIBLE FOR FEDERAL STUDENT AID BASED ON NEED AND SATISFACTORY PERFORMANCE IN SCHOOL. LEVEL OF ATTENDANCE WOULD NO LONGER BE A CONSIDERATION FOR THE PURPOSES OF DETERMINING AID.

THE TRADITIONAL IMAGE OF AN UNDERGRADUATE IS A TWENTY YEAR OLD FULL-TIME STUDENT WHO LIVES IN A DORM FOR FOUR YEARS AND THEN GRADUATES. HOWEVER, THAT REPRESENTS ONLY ABOUT 20 PERCENT OF COLLEGE STUDENTS TODAY. A MORE ACCURATE PICTURE IS A TWENTY-FIVE YEAR OLD FEMALE WHO LIVES OFF CAMPUS, WORKS ALMOST FULL TIME, AND COMMUTES TO A COMMUNITY COLLEGE. SHE POSTPONES HAVING CHILDREN UNTIL SHE EARNS A DEGREE, OR SHE JUGGLES FAMILY AND SCHOOL. OF THE APPROXIMATELY 13 MILLION COLLEGE STUDENTS, 55 PERCENT ARE FEMALE; 45 PERCENT ARE AT LEAST 24 YEARS OLD; 40 PERCENT ATTEND SCHOOL PART-TIME; AND NEARLY 30 PERCENT ARE MARRIED. THE NUMBER OF PART-TIME STUDENTS IS EXPECTED TO GROW TO 60 PERCENT BY 1995. AND NOT ALL PART-TIME STUDENTS ARE OLDER: 20 PERCENT OF STUDENTS UNDER AGE 24 ATTEND SCHOOL ON A PART-TIME BASIS.

DESPITE THE TREND TOWARD ATTENDING SCHOOL ON A LESS-THAN-HALF TIME BASIS, ONLY SIX PERCENT OF THESE NEEDY STUDENTS RECEIVED PELL GRANTS LAST SCHOOL YEAR. IN 1989, IN HIS REPORT TO THE CONGRESS ON LESS-THAN-HALF TIME STUDENTS, FORMER SECRETARY OF EDUCATION LAURO CAVAZOS CONCLUDED THAT "SUCH STUDENTS DESERVE OUR ENCOURAGEMENT AND SUPPORT AND SHOULD NOT BE DENIED ACCESS TO TRAINING THAT MAY BETTER THEIR JOB SKILLS OR EMPLOYMENT OPPORTUNITIES SOLELY BECAUSE THEY ARE UNABLE TO ENROLL FOR MORE THAN ONE OR TWO CLASSES AT A TIME."

AT THE SAME TIME, THESE "NON-TRADITIONAL" STUDENTS ARE NOT ELIGIBLE FOR FEDERALLY-INSURED STUDENT LOANS. TRULY, MR. CHAIRMAN, MANY OF THESE

STUDENTS HAVE NO ACCESS TO ANY FORM OF STUDENT AID. MY LEGISLATION IS AIMED AT HELPING THESE STUDENTS BY ALLOWING THEM ACCESS TO THE GUARANTEED LOAN AND GRANT PROGRAMS, BASED ON FINANCIAL NEED AND RESOURCES.

MR. CHAIRMAN, AS THE CONGRESS BEGINS THE PROCESS OF REAUTHORIZING THE HIGHER EDUCATION ACT, LET US BE MINDFUL OF THE NEED THAT IS NOT BEING MET; OF THE CHANGES THAT ARE HAPPENING ON OUR COLLEGE CAMPUSES; AND OF THE NEED TO ADEQUATELY TRAIN ALL PEOPLE TO MEET THE CHALLENGES THAT CONFRONT THIS COUNTRY. THANK YOU, MR. CHAIRMAN.

AMERICAN MEDICAL ASSOCIATION
[illegible]

JAMES S. TODD, M.D.
Acting Executive Vice President

May 21, 1990

The Honorable Timothy J. Penny
U.S. House of Representatives
436 Cannon House Office Building
Washington, DC 20510

RE: Support for H.R. 4690 to
Allow Deferment of Student
Loans During Professional
Internships

Dear Representative Penny:

The American Medical Association wholeheartedly supports your bill, H.R. 4690, to allow individuals serving in professional internships, which includes medical residents, to defer repayment of their student loans. Your proposed change in the law is urgently necessary for many current medical residents hoping to finish their residencies, for ensuring that qualified individuals always will be able to choose medicine as a career, no matter their financial status, and for ensuring an adequate supply of physicians in underserved areas and in some medical specialties.

As you well know, the ability to defer such payments was suddenly taken away from many medical residents through provisions included in the Omnibus Budget Reconciliation Act of 1989 (P.L. 101-239). This change in the law will require many medical residents, beginning for most in July of this year, to make unexpected monthly payments of $500 to $700 a month on resident salaries that are typically about $2200 a month.

Unless your bill is enacted soon, some medical residents will not be able to finish their residency programs, while others will be forced to place themselves in even more tenuous financial situations — through additional debt or forbearance provisions of OBRA of 1989 — that will only exacerbate an already difficult medical education debt situation. Of medical school graduates in 1989, 81% were indebted, with average debts of $42,374. Of osteopathic medical school graduates in 1989, 93% were indebted, with an average debt amount of about $67,000.

Unreasonably high levels of educational debt keep many qualified individuals from being able to choose medicine as a career. High debt also keeps young physicians from being able to establish practices in medically underserved areas where they are most needed but where financial rewards are not as high. An article just published in AMNews, which is enclosed, points out how difficult it is for rural communities in Minnesota and other areas to attract physicians for a variety of reasons, including young physicians' high level of education debt.

In addition, if residents are unable to pursue the full range of residency training programs, which can last up to 5 or 7 years for some primary care specialties, the future availability of certain medical specialties may be threatened. A one- or two-year internship — the length of time student deferment is allowed under current law — merely allows physicians to be licensed. It does not allow a physician to be certified in any of the specialties for which needs are being projected. Again, underserved rural and inner-city areas will be the first to feel he effects of limited access to specialized care.

Medical residents are in a difficult position. It is not easy for many to understand that, while medical residents receive salaries that vary widely, they have had to assume enormous amounts of educational debt even to become medical residents, and that their residency programs are a necessary part of their educational process. We are not aware of any other professional group that is required, under federal student loan policies, to begin paying back their student loans before completing their educations. Medical residents only ask that they be allowed to finish their necessary educational process before they begin paying back their educational debt.

The AMA commends you for your interest in this important health care issue. We offer our assistance in any way possible to help you see that this important bill soon becomes law.

Sincerely,

James S. Todd

James S. Todd, MD

JST/dlh
3470p

enclosure

BEST COPY AVAILABLE

AAMC

ASSOCIATION OF
AMERICAN
MEDICAL COLLEGES

ONE DUPONT CIRCLE, NW
WASHINGTON, DC 20036
TELEPHONE (202)828-0400

June 11, 1990

The Honorable Timothy J. Penny
U.S. House of Representatives
436 Cannon House Office Building
Washington, D.C. 20515

Dear Representative Penny:

On behalf of the Association of American Medical Colleges (AAMC) and the 66,000 medical students, 126 medical schools, 81,000 medical residents, 420 teaching hospitals, and 90 academic and professional societies we represent, I would like to thank you for introducing legislation to lengthen the internship deferment in Title IV of the Higher Education Act. The medical education community is deeply concerned about escalating debt levels of medical students and residents. By allowing medical residents to defer repayment of Stafford and Perkins student loans for the entire length of their residencies, H.R. 4690 would go a long way toward mitigating adverse effects of educational indebtedness.

As you know, the cost of medical education requires most medical students to borrow heavily to finance their education. Among 1989 graduates, 81 percent were indebted with an average debt of $42,374. Twenty-nine percent of these graduates had debts in excess of $50,000. Among underrepresented minority medical school graduates, indebtedness levels are even larger. Ninety-one percent of 1989 minority graduates were indebted. Their average debt was $48,168; 41 percent had debts above $50,000.

The education of a physician does not end at graduation from medical school. In order to be fully trained to practice medicine, new physicians must serve in residency programs. These programs last from three to seven or more years, depending on the chosen specialty. As part of their training, medical residents are engaged in the provision of clinical services to hospitalized and ambulatory patients for which they are provided a stipend of approximately $25,000 per year. With the debt levels most medical students are incurring, current stipends do not generally provide enough support for residents--who are in their late twenties and early thirties--both to meet family living expenses and to repay their educational debts. The ratio of the cost of loan repayment to income is typically considered manageable if the cost does not exceed eight percent of gross income. For the average indebted medical resident, loan repayment costs are about $3,400 a year--close to 14 percent of gross income. For the most highly indebted, these costs can be 25 percent and more of gross income. Currently, because the deferment on Stafford and Perkins student loans ends after the second year of residency training, a significant number of residents face unmanageable loan repayment costs.

The longer deferment period as envisioned by H.R. 4690 would ease the indebtedness problem by delaying loan repayment until training has been completed. As importantly, it would prevent residents' debt levels from escalating further, thereby increasing their capacity to choose lower-paying fields in teaching and research or to make commitments to practice in underserved communities. Given the federal commitment to equal educational opportunity and the importance of a well-trained physician workforce to the nation's welfare, a longer deferment during medical residency is justified.

The AAMC commends your leadership in this important area of higher education and your efforts to help medical residents and others whose educational programs necessitate long postgraduate training periods.

Sincerely yours,

Robert G. Petersdorf, M.D.

AMERICAN
ASSOCIATION
OF DENTAL
SCHOOLS

1625 MASSACHUSETTS AVENUE, N.W.
WASHINGTON, D.C. 20036

202/667-9433

May 7, 1990

The Honorable Timothy J. Penny
House of Representatives
Washington, D.C. 20515

Dear Congressman Penny:

On behalf of the American Association of Dental Schools (AADS), I would like to thank you for introducing H.R. 4690, the Student Loan Deferment bill.

As you know, student loan indebtedness is an increasing problem among dental graduates, especially among minority students. Indebtedness is a major concern in dental education because federal grant support is available only to a small portion of our most needy students. The majority of dental students, therefore, must borrow to finance their education, and the annual escalation in the level of educational debt is of serious concern. Indebtedness levels among graduates of health professions schools have increased almost 200 percent in the last decade.

Dental educators worry that these debt burdens are becoming unmanageable for many borrowers, particularly during the first few years after repayment when many dentists are still in training in a residency program. Some of these dental residents are required to pay tuition or receive only a small stipend that makes repayment of their student loans very difficult. Your bill to permit the deferral of payments on Federally-insured student loans for the full duration of the period during which borrowers are enrolled in professional internships or residencies is an important step in making debt burdens more manageable for many health professions borrowers. We believe that the bill will also help avoid defaults by residents who do not wish to evade financial responsibility, but who are temporarily financially incapable of loan repayment.

Ms. Marty Liggett, Director of Government Affairs at AADS, has been in contact with Joe Theissen concerning this important legislation. We look forward to working with you on this matter. Again, thank you for sponsoring H.R. 4690 and for your continued support for dental education.

Sincerely,

Richard D. Mumma, Jr.
Executive Director

Mayo Foundation
for Medical Education and Research

Rochester, Minnesota 55905 Telephone 507-284-2511

Bruce M. Kelly
Governmental Affairs

May 29, 1990

Representative Timothy J. Penny
436 Cannon House Office Building
Washington, D.C. 20515-2301

Dear Mr. Penny:

On behalf of Mayo Foundation, I want to express our support for your bill H.R. 4690, providing for deferment of student loans for medical residents. We agree that the inability to obtain deferment of these loans beyond the first two years of resident training may lead some medical residents to either choose the most lucrative specialties, or to choose specialties with short resident training periods.

If we can be of any assistance to you with respect to this legislation, please do not hesitate to contact me at (507) 284-5904.

Sincerely,

Bruce M. Kelly

BMK:zl
cc: Alan D. Sessler, M.D.

Resident Forum

Resident Physicians Section

Student Loans: Deferment and Forbearance Provisions

The American Medical Association (AMA) is opposed to a provision that Congress included in the 1989 Omnibus Budget Reconciliation Act (Pub L No. 101-239) that prevents some resident physicians from deferring repayment of Stafford student loans beyond a 2-year period. It is the AMA's position that all resident physicians should be able to defer student loan repayments throughout residency training, since serving a residency is a necessary part of a physician's education.

Previously, those who served in residency programs that had a major university affiliation were classified under student deferment provisions of the law as "in school" and were able to defer repayment of their Stafford student loans throughout their residencies. As a $10 million cost-saving measure, the most recent Omnibus Budget Reconciliation Act rescinds that classification for residents as of January 1, 1990.

See also p 1102.

In what is intended to be a partial alternative, the legislation provides "forbearance" without penalty or cost to the borrower. Forbearance is unlike deferment in two critical respects: interest continues to accrue on the outstanding principal during forbearance, and the total 10-year repayment period may not be lengthened to accommodate the forbearance periods. Whether the period is lengthened is up to the discretion of the lender. For example, a resident who defers payment for 2 years and then takes forbearance for 2 years may have his loan repayment period reduced to 8 years. Because borrowers must pay back accumulated interest and principal over a loan repayment period (normally 10 years) that will be reduced by the number of years of forbearance, making payments will be that much more difficult.

The law does provide that no administrative or other fee may be charged in connection with granting forbearance and that no adverse information regarding the borrower may be reported to a credit bureau organization solely because forbearance is granted.

The denial of in-school status, along with the elimination of the tax deductibility of student loans by Congress in 1986, threatens the ability of many resident physicians to complete their education. According to the Association of American Medical Colleges, 83.4% of all 1988 medical school graduates had educational debt, with a total average indebtedness of $38 489, an 8% increase above the 1987 level. Of those with debt, 24% have a total educational debt of more than $50 000. The average total debt for graduates of private medical schools in 1988 was $48 068, and for public medical school graduates it was $31 370. Monthly student loan payments of at least $500 to $700 are not uncommon for resident physicians with typical monthly salaries of $2200 to $2300 in programs that often are located in urban areas with high costs of living.

The AMA is committed to the principle that qualified individuals of all financial and social backgrounds who want to be physicians should have the opportunity to do so. Clearly, the inability to defer loan repayment while completing an education and to deduct student loan interest will keep some otherwise deserving individuals from following through on their desire to become physicians or force those who do become physicians to choose medical practices in more lucrative geographic areas rather than in areas with high need that would offer less income potential.

The AMA will redouble its efforts to see that loan deferment throughout residency training is established, regardless of the kind of training institution, and that the tax deductibility of student loan interest payments is restored.

Edited by Terrell B Michael Department Director

Wanted: Good doctor. Low rates, long hours, but community's love

By Sharon McIlrath
AMN STAFF

SANDSTONE, Minn. — John Wright says he and other merchants flat-out begged Alison Little, MD, to spend one more year in their small town.

"She's such a good doctor, and we are so desperate that us merchants were willing to do whatever it takes," the gregarious mayor of Sandstone recalls.

Everyone knew the popular young physician would be leaving after a three-year stint with the National Health Service Corps. Most weren't aware that NHSC scholarship recipients can buy out of their service obligation, however. So it hadn't dawned on anyone that Dr. Little might leave Sandstone when her husband finished his NHSC obligation and accepted a position on the West Coast.

Searching for doctors is a permanent occupation for Wright and a committee set up by the hospital's director of nursing, Vivian Swanson, RN. Without more doctors to build up its patient base, the North Pine Area Hospital can't keep its doors open much longer. So the financially ailing facility is offering a $75,000 salary plus fringe benefits and professional liability insurance to any good doctor who'll come to Sandstone.

Swanson spends half her time wooing potential candidates. The power company has produced a video extolling the community's merits. And the Lions Club is offering a $5,000 bonus to any doctor who accepts the hospital's offer.

Two young physicians just completing training have shown an interest in the town. North Pine Hospital recently won designation as a rural clinic, thus upping its reimbursement from Medicare and other public programs. A request for federal funds to convert part of its unused facilities into assisted living units has just gone in. And Dr. Little, after an emotional meeting with Wright and the procurement committee, has agreed to stay behind in Minnesota one more year.

With Sandstone already spending more than $30,000 a year to recruit unknown new doctors, Wright says the committee thought keeping "the excellent doctor we already had" was worth at least $5,000 in perks. They offered the young MD and mother a menu of choices, including help financing new living arrangements, a nanny for the children, round-trip air fare, or long-distance telephone calls.

In the end, the price of keeping their doctor was an agreement that relieves her of taking call every other night and permits her to spend more time with her children.

AT A TIME when three out of four rural Minnesota hospitals are spending $10,000 to $50,000 a year and an average of 17 months looking for doctors, Sandstone's experience is typical. Across the country, rural hospitals, doctors, and communities are resorting to Wild West tactics such as bounties and wanted posters to capture physicians.

Salary guarantees are common. More recently, some towns have paid off medical school loans as the price of acquiring a physician. In Maine, six logging towns paid for the medical training of the young man who is now caring for their citizens.

But even those that successfully hunt down a physician have few guarantees. By one recent estimate, one out of four rural doctors is thinking of leaving. Some will go to another rural town. Many will not.

One rural town pilfers from another, says Jim Przybilla of Utah's Rural Health Office. Then headhunters from cities and other states steal from all the rural areas, as in the case of a California clinic that recently snared a Utah family physician with a $170,000 salary. In fact, the Utah manpower specialist adds, he considers himself lucky when the doctors he recruits stay at least four years.

All told, about 100 rural counties with about 365,000 people have no doctor at all. And 1,300 non-metropolitan communities with nearly 17 million people are so short of physicians and other practitioners that they have been officially declared health manpower shortage areas (HMSAs) by the federal government.

To supply these areas alone would take at least 2,000 more doctors or limited license practitioners. But in the view of many rural doctors looking for colleagues to reduce their work load, the real need is far greater. "All rural areas are shortage areas," declares Moose Lake, Minn., physician Raymond Christensen, MD, who is recruiting two more doctors for his overworked clinic in that non-HMSA area.

As president of the Northern Lakes Health Care Consortium, Dr. Christensen and consortium Director Terry Hill are all too familiar with the barriers to recruiting and retaining rural physicians. Like most who have looked at the issue, they point to four factors that discourage rural practice.

At or near the top of everyone's list is low payment. Two others — long, irregular hours and professional isolation — also appear without fail. Underlying all the rest is a medical education system that critics say fails to prepare students for rural practice and leaves them so in debt that rural primary care practice isn't feasible.

FAMILY PHYSICIAN Barbara Yawn, MD, writes a newsletter called "Country Doctor" and does a weekly patient education radio show. She and her internist husband, Roy, went to Worthington, Minn., because they were "fed up with city traffic and wanted to raise our children in a rural area." But she also wanted a practice where "I could be a part of my patients' lives" and "wouldn't always have a consultant looking over my shoulder."

Her practice met those needs, and because she was part of a multispecialty group in a town of 10,000, she didn't experience a great deal of professional isolation. Still, she says, rural practice is different, and educators need to recognize that.

"You're not going to have a cardiologist right there," she explains. "So you're going to have to be able to take care of an MI and make some decisions about who needs to be transferred out. You have to be able to recognize and transfer the high-risk obstetrical situations as well as be prepared to handle the ones you can't predict. And you have to learn to work over long distances with a consultant you don't see in the coffee room or over lunch."

While the country doctor may be professionally isolated, however, the physician-journalist adds, "you can't stay isolated" from the community.

"We started locking our doors because if your phone is off the hook and the hospital needs you, the police just walk right into your house at 3 in the morning," Dr. Yawn laughs. "You see all your patients at the grocery store. They know what you eat. They know what your kids did in school today and they know if you got a speeding ticket."

Some physicians and their families enjoy that, she adds, while "others need more personal freedom." Probably the biggest detraction in her view, however, is the hours country doctors keep.

"The first five years I was here I was on call every night and then for the next seven, every other night," says the mother of two. "Going out in the middle of the night is not so bad when your kids are little. When she was young, my 14-year-old always got up and we played for a while. You can do that with a 2-year-old. But when they are older and you get beeped in the middle of their band concert, it's very frustrating."

IN SUBURBAN Minneapolis, Bruce Adams, MD, has kept his hand in rural medicine through his ties with a rural emergency medical system he helped build. But he says the hours required of small-town practitioners are what drove him back to an urban emergency department.

In part, he left tiny Aitken, Minn., to put his skills to greater use in the high-volume city ER that had been courting him for five years, Dr. Adams explains, "but the main thing prompting the move was the need to be constantly on call every fourth night."

When he first went to north central Minnesota in 1975, the busy doctor found work in a rural community, where he "could make an unbelievable difference, highly gratifying." His patients were stoic, hard-working people like the dairy farmer who insisted on having an injured finger amputated because surgical repair would have meant more time away from his cows.

Gradually, however, Dr. Adams began to see more demanding people who called 911 for minor injuries and often had been sick for several days before showing up at the emergency room in the middle of the night. City patients are no different, he adds. "But now I'm only exposed to it for eight hours a day."

Raymond Christensen, MD
Too many recruitment barriers, so all rural areas are shortage areas.

IN FACT, the experts say, a new generation of physicians has become increasingly averse to the workaholic hours required in rural communities. And that, along with other trends, spells even bigger trouble for rural health in the years ahead, says Terry Hill of the Northern Lakes Consortium.

By the year 2000, he calculates, the United States "is going to need 45% more physician visits due to the aging of the population." But many rural physicians are nearing retirement age, and their communities will probably need one and a half to two new doctors to replace each of "the old workhorses out there now."

Their chances of recruiting even one, however, are dimming, Hill believes. For one thing, the medical jack-of-all-trades that rural communities need are a scarcer commodity. With the soaring costs of medical education, students with massive debts (in 1989 the mean was $42,200) have gravitated to lucrative high-tech specialties.

Not surprisingly then, the number of family practice residents has dipped (from 7,486 in 1984 to 7,392 in 1989) recently. So with the booming managed care industry "recruiting like wildfire" for primary care gatekeepers, the approximately 2,300 FPs who enter practice each year can choose from almost 13,000 openings.

To make matters worse, fewer and fewer of the rural and farm youths who would be most likely to return to small-town practices are applying to medical schools. Add to that an upturn in the number of women (just under a third of those entering first-year FP residencies) in medicine, and Hill thinks small towns are going to be put to a severe test.

ALWAYS a significant consideration, the issue of the physician spouse becomes particularly important in the case of female physicians. One hospital administrator relates a colorful tale of a successful effort to find work in the wilds of Montana for a physician spouse who had been trained as a Porsche mechanic. But most doctors' husbands tend to be lawyers, medical specialists, and other professionals with limited career opportunities in small-town America.

In addition, like Dr. Little, many young women find child rearing and long hours incompatible. Dr. Yawn thinks innovative communities might still attract young women with the promise of job-sharing. But some rural clinics report that they have lost good women doctors to lower-paying 9-to-5 jobs with urban HMOs. Others say FPs and general internists increasingly are, like Bruce Adams, opting for the regular hours and higher pay of the hospital emergency department.

Once many of these rural communities would have drawn on the National Health Service Corps to step into the hardest-to-fill vacancies. But as Sandstone has found, that option has nearly disappeared.

Once more than 3,000 strong, the corps was targeted for elimination by the Reagan Administration. Now in its 20th year it has a field strength of about 1,700. Without congressional action (which is under consideration), the numbers will fall even more dramatically in the next two years.

"There's just no getting around it," concludes Hill. "We've got a problem now. But like a train coming down the track, we are going to be experiencing a real crisis in the next few years."

Lawrence Tsen
4449 Francis Street
Kansas City, Kansas 66103

July 5, 1990

Mr. Joe Theissen
Office of the Honorable Timothy J. Penny
U.S. House of Representatives
436 Cannon House Office Building
Washington, D.C. 20515

Dear Mr. Theissen:

On behalf of the Organization of Student Representatives (OSR) to the Association of American Medical Colleges (AAMC), I would like to thank you for meeting with me regarding H.R. 4690 which allows resident physicians to defer repayment of their Title IV student loans while completing resident training programs.

Even at my state supported medical institution, the University of Kansas, a student can accumulate enormous debt loads; upon my graduation next year, I will owe in excess of $50,000. Compared to national statistics, these figures are not unusual. Among 1989 graduates, 81 percent were indebted with an average debt of $42,374, with 29 percent having debts in excess of $50,000. Among underrepresented minority medical school graduates, the figures are even more staggering: Ninety-one percent of 1989 minority graduates were indebted with an average debt of $48,168, with 41 percent having debts above $50,000.

I am commited to repaying my loans but am concerned about those potential medical students who are rethinking their career decisions, and my current medical colleagues who are rethinking their specialty and geographic decisions in light of the financial obligations of attending medical school. H.R. 4690 will ease this preoccupation with indebtedness. I appreciate your assisting Congressman Penny's efforts in this important area of higher education.

Sincerely yours,

Lawrence Tsen

Lawrence Tsen
OSR Chair-Elect

Johnson, MD
CMC
pt of Orthopaedic Surgery
315 Stockton Blvd
acto, CA 95817

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7/29/90

Dear Congressman Penny:

I am a resident in orthopaedic surgery at the University of California, Davis. I am, however, originally from Minnesota and so I am familiar with you. I would just like to thank you for sponsoring H.R. 46 to extend residents deferments beyond two years. I, l most resident physicians, am more than willing to pa back my loans, with interest. But it is simply not fair to ask people with fixed moderate incomes to be repaying very large debts. Thank you for understandin this and sponsoring HR 4690 - we appreciate this!

Sincerely
Paul J MD

H. ext. deferment. thanks

I

102D CONGRESS
1ST SESSION

H. R. 179

To amend the Higher Education Act of 1965 to permit the deferral of payments on students loans during professional internships, regardless of duration.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 3, 1991

Mr. PENNY (for himself, Mr. CALLAHAN, Mr. TOWNS, Mr. NCNULTY, Mr. COLEMAN of Texas, Mr. LANCASTER, Mr. WOLPE, Mrs. SCHROEDER, Mr. OLIN, Mr. FRANK of Massachusetts, Mr. PAYNE of Virginia, Mr. VANDER JAGT, Mr. BEREUTER, Mr. MCGRATH, Mr. VENTO, Mr. WISE, Mr. RAVENEL, Mr. KLECZKA, Mr. MCDERMOTT, Mr. ERDREICH, Mr. DEFAZIO, Mr. MACHTLEY, Mr. JOHNSON of South Dakota, Mr. FROST, and Mr. HENRY) introduced the following bill; which was referred to the Committee on Education and Labor

---

A BILL

To amend the Higher Education Act of 1965 to permit the deferral of payments on students loans during professional internships, regardless of duration.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. FINDINGS AND PURPOSES.

(a) FINDINGS.—Congress finds that—

(1) the interest subsidy provided borrowers of title IV loans during periods of internship or residency is

critical to the borrower's ability to complete his or her educational program;

(2) a number of professional degree programs have an essential postgraduate training component that can last from one to seven or more years;

(3) health professions programs, in particular, require periods of postgraduate training for reasons relating to qualification to practice, licensure, specialty certification, or access to hospital privileges;

(4) the educational indebtedness of graduates of professional degree programs has reached unprecedented levels;

(5) the educational indebtedness levels of underrepresented minority graduates are even greater than they are among indebted graduates as a whole;

(6) given the level of financial support provided to borrowers in postgraduate training programs (primarily through stipends), debt levels such as these can make loan repayment obligations extremely difficult to meet;

(7) growing debt burdens may discourage pursuit of advanced training, adversely affect career choice, create financial barriers to practicing in remote locations, and exacerbate minority underrepresentation in certain professions; and

(8) many health professional graduates who are committed to caring for underserved community find this career path infeasible in light of their enormous debt burdens and the inability to defer their loan payments throughout the period of residency training.

(b) PURPOSE.—It is the purpose of this Act—

(1) to permit the deferral of payments on student loans throughout the duration of post-graduate internships and residency programs; and

(2) to ensure that loan repayment obligations are not acting as a disincentive to advanced training and adversely affecting career choice and service to the poor and underserved by temporarily alleviating loan repayment requirements for borrowers serving in internship and residency programs.

SEC. 2. AMENDMENTS.

(a) GSL PROGRAM.—Section 428(b)(1)(M)(vii) of the Higher Education Act of 1965 (20 U.S.C. 1078(b)(1)(M)(vii)) is amended by striking "not in excess of two years".

(b) FISL PROGRAM.—Section 427(a)(2)(C)(vii) of the Higher Education Act of 1965 (20 U.S.C. 1078(b)(1)(M)(vii)) is amended by striking "not in excess of two years".

(c) NDSL PROGRAM.—Section 464(c)(2)(A) of the Higher Education Act of 1965 (20 U.S.C. 1087dd(c)(2)(A)) is amended by striking out the following: "The period during which repayment may be deferred by reason of clause (vi) shall not exceed 2 years.".

SEC. 3. EFFECTIVE DATE.

The amendments made by section 1 of this Act shall apply on or after the date of enactment of this Act with respect to loans made under the Higher Education Act of 1965 before, on, or after that date.

Chairman Ford. Mr. Shaw.

STATEMENT OF THE HONORABLE E. CLAY SHAW, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. Shaw. Thank you, Mr. Chairman.

I have a statement prepared by Leslie Waters of my staff which you have already placed in the record, so I will summarize in a very merciful fashion.

Mr. Chairman, Mr. Coleman, members of the committee, I, of course, want to thank you for your patience and indulgence in asking us to testify today. You, better than any other in the Congress, recognize the pending crisis that we have in education in this country, with a tremendous shortage of teachers. Now is the time to attack this problem.

Over the next decade, it has been estimated that 2 to 2.5 million teachers will be needed in order to just fulfill the demand that is anticipated in the schools at the present level. That number of teachers is not in sight. My bill simply builds upon the present law, which allows a 3 year deferment for the payment of student loans by new teachers in areas of greatest need. It extends that idea to the student loan, when students are paying it back, by cutting the amount of interest payable on these loans in half.

Right now the repayment interest is 8 percent. For teachers in the area of critical need, that would be reduced to 4 percent as long as they continue teaching in that area. If they leave the profession, then their student payments return to the full 8 percent, but never do they have to go back and repay the discounted portion for the period during which they taught.

One other point that I would like to make, on the national study that was done with regard to eighth graders in science and math, and also recognizing the shortage of teachers in those areas. My bill could be readily amended by this committee to give special consideration to teachers who go into that area.

I think there are other bills around the Hill right now that are addressing the pending teacher shortage, which is going to be of crisis proportion. I commend this committee for getting ahead of the curve and trying to solve the problem.

Right now my bill has about 75 or 76 cosponsors, many of which are on this committee. It is a straightforward approach, and it would be a very effective method. Unfortunately, I do not, at this point, have the figures from OMB as to exactly what the cost impact of this bill is going to be, but I am sure that they will be available before the committee commences with its markup.

Thank you, Mr. Chairman.

[The prepared statement of Hon. E. Clay Shaw, Jr., follows:]

Insert 2A

STUDENT LOAN DEFERRALS FOR TEACHERS

TESTIMONY BY CONGRESSMAN E. CLAY SHAW, JR.
BEFORE THE SUBCOMMITTEE ON POSTSECONDARY EDUCATION
WEDNESDAY, JUNE 19, 1991

Chairman Ford, Mr. Coleman, and Members of the subcommittee, I thank you for the opportunity to testify before you regarding my bill, H.R. 709, an amendment to the Higher Education Act of 1965.

While there are many ways to reform education, the best way to secure excellence in our classrooms is by recruiting highly talented and well-trained teachers. Unfortunately, however, we are losing our most talented students, and future teachers, to better-paying jobs. This problem is compounded for those students who have loans to repay. Furthermore, our nation is facing a substantial loss of teachers to retirement in the next decade. This loss of teachers to retirement threatens our nation's already strained supply of teachers.

My proposal has two objectives -- to make it financially easier for students to choose teaching as a career and to encourage those who choose teaching to remain in the field.

The Higher Education Act requires teaching in a teacher shortage area as a prerequisite for a three-year deferral of Guaranteed Student Loans. The shortage areas are established by the Secretary of Education. After the deferral, my proposal would allow for repayment of the GSL at half the normal interest rate

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for as long as the person remains a full-time teacher. As the current rate for a GSL is 8%, any student taking advantage of the discount would therefore repay the loan at 4%. If he or she should decide to stop teaching full-time, any remaining payments would be made using an 8% interest rate.

I have included as an appendix a 1990 regional salary analysis provided by the Association for School, College and University Staffing, Inc. According to this report, the average starting salary for a teacher in 1990 was $19,000. The U.S. Department of Education estimates that just tuition and required fees are approximately $1,781 per school year for an in-state student at a public institution. This number skyrockets to $8,446 for a private institution. These rates generally increase at a rate of 6% to 7% a year.

The latest figures from the U.S. Department of Education for student debt is for those students who graduated in 1986. In that year total average indebtedness was $6,810 for public college graduates and $10,000 for those coming out of private schools. I think it is safe to assume that these figures have risen significantly in the 5 years since those figures were compiled.

As a result of the gap between salary and debt, those who want greater compensation, or simply think they won't be able to afford to repay their loans on a teacher's salary, choose more lucrative careers. Many who currently teach will eventually leave the classroom for educational administration or for non-educational fields.

A cover article published in the September 1990 edition of "Education Week" recognized that, as the competition increases in the future among employers seeking to hire from a shrinking pool of young college graduates, graduates will be less likely to choose teaching. Similarly, it has been forecasted that prospective teachers will have more lucrative options in the 1990's then they had in the 1980's.

As a result of state budget cuts, some areas are laying off teachers. I know this is of concern to many of you, and I assure you it is a concern of mine as well. This is happening in my own congressional district in South Florida. For this reason I would like to stress that my proposal focuses on areas suffering from shortages.

The nation as a whole will continue to suffer from an acute shortage of teachers. Experts say the United States will need 2 million new teachers over the next decade. Some believe the number might be as high as 2.5 million. That would mean as many teachers will be in demand in the next 10 years as are currently teaching today. If current trends continue, the U.S. will graduate less than half that number.

In my appendix I have included reprints of tables outlining expected shortages also documented in the ASCUS 1990 study. By region, Alaska reported the greatest teacher shortages, and the Southeast, South Central, and Western regions of our country follow in terms of reported shortages.

The need for teachers is becoming even more urgent as policy makers anticipate a wave of retirements in the field. According to a study prepared by the National Center for Education Statistics, half of those teaching in 1987-88 were age 40 or older. Many will be leaving their jobs within the next decade. A disproportionate number of these are the most experienced and skillful teachers, primarily talented women who had few other career choices when they entered the teaching profession. Some experts have estimated that as much as 6% of the teaching force is leaving the profession each year.

My proposal addresses both of the problems I have outlined for you. First, by offering a discounted interest rate, my amendment to the HEA encourages more qualified students to enter the teaching profession instead of choosing other, more lucrative, careers. To further ease the burden of repayment, the three-year deferral will allow time for the teacher's salary to reach a higher income level before loan repayment begins.

Secondly, my proposal addresses shortages by incorporating the three-year deferral requirement to teach in a shortage area. Furthermore, it encourages teachers to remain in the classroom. For the individual to benefit from the discounted rate, he or she must continue to teach.

I wish that I could provide a cost estimate on my proposal for you today. The Congressional Budget Office was unable to fulfill my request in time for this hearing, but has promised to get one to me shortly.

On a different note, Mr. Chairman, I want to take a moment to mention the recent national study which showed the nation's eighth graders have dangerously low levels of math and science proficiency. This does not come as a surprise considering studies report critical shortages of teachers in the math and science fields.

The National Center for Education Statistics has found a substantial number of teachers who did not major in math or science in college and are pressed into teaching these subjects as a result of the shortage. For this reason, I would not object if the subcommittee amended my proposal to also specifically address this problem.

In his stated national education goals, the President set being number one in the world in math and science as one of six goals to be reached by the year 2000. We have an opportunity here to help realize this goal.

Mr. Chairman, and Members of the subcommittee, The Higher Education Act is the primary federal source of improvement for the recruitment, retention, and preparation of elementary and secondary school teachers. My proposal takes the Act a step further and recognizes that the success or failure of any broad scale effort to reform education will depend upon the capacity of, and support for, individual classroom teachers.

By supporting my proposal, I believe that the subcommittee will significantly enhance the ability of our young people to seriously consider a teaching career. I know that all of you are looking for ways to improve our educational system, and hope you find merit in my ideas.

I thank you for your time, and urge your favorable passage of H.R. 709.

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Figure 1
ASCUS Supply/Demand Regions: 1–Northwest, 2–West, 3–Rocky Mountain, 4–Great Plains/Midwest; 5–South Central, 6–Southeast, 7–Middle Atlantic, 8–Northeast

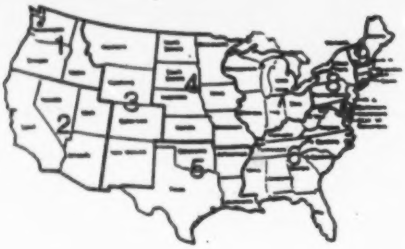

Table 3. Average Salary Reports

		Special Education		Elementary/Secondary	
		Bachelors	Masters	Bachelors	Masters
Region 1	1987-1988	16,482	18,899	16,899	18,959
	1988-1989	16,725	19,800	16,794	19,584
	1989-1990	17,793	20,908	17,793	20,035
Region 2	1987-1988	21,032	22,538	20,367	21,403
	1988-1989	20,573	23,179	20,909	21,218
	1989-1990	21,862	24,608	21,601	23,018
Region 3	1987-1988	17,482	19,425	17,454	19,048
	1988-1989	17,962	22,900	18,129	21,468
	1989-1990	18,083	25,223	18,942	22,916
Region 4	1987-1988	17,548	19,425	16,898	18,968
	1988-1989	17,723	20,345	17,523	20,013
	1989-1990	18,869	21,700	18,405	20,798
Region 5	1987-1988	17,353	18,498	16,981	18,114
	1988-1989	17,927	19,339	17,817	19,123
	1989-1990	18,764	20,862	18,405	20,093
Region 6	1987-1988	17,855	19,313	17,848	19,025
	1988-1989	18,730	20,763	18,362	20,298
	1989-1990	19,235	21,038	19,878	21,167
Region 7	1987-1988	17,123	20,048	16,483	19,484
	1988-1989	17,837	20,580	17,669	20,463
	1989-1990	18,811	21,249	18,402	21,276
Region 8	1987-1988	19,225	21,331	18,338	20,531
	1988-1989	20,152	22,515	19,625	22,321
	1989-1990	21,314	24,303	20,440	23,638
Region 9	1987-1988	18,436	20,410	17,725	20,515
	1988-1989	18,911	20,508	18,082	20,044
	1989-1990	20,166	22,200	19,403	21,869
Alaska	1987-1988	26,000	31,000	26,000	31,000
	1988-1989	30,000	40,000	30,000	40,000
	1989-1990	30,000	40,000	30,000	40,000
Hawaii	1987-1988	N/A	N/A	N/A	N/A
	1988-1989	N/A	N/A	N/A	N/A
	1989-1990	23,381	24,581	23,381	24,581

From data supplied by survey respondents. In some instances, the averages are based upon limited input, and total reliability is not assured.

Table 1. Teacher Supply and Demand by Field and Region

Regions are coded: Alaska, Hawaii, 1 - Northwest, 2- West, 3 - Rocky Mountain, 4 - Great Plains/Midwest, 5 - South Central, 6 - Southeast, 7 - Great Lakes, 8 - Middle Atlantic, 9 - Northeast. Alaska and Hawaii are not included in the national totals for years prior to 1990.

5 = Considerable shortage; 4 = Some Shortage; 3 = Balanced; 2 = Some Surplus; 1 = Considerable Surplus

Field	Region											National
	Alaska	Hawaii	1	2	3	4	5	6	7	8	9	1990
Agriculture	2.00	4.00	3.50	3.00	2.75	2.77	2.00	2.77	3.54	4.00	—	3.03
Art	2.00	1.00	1.25	2.26	2.00	2.52	2.06	2.48	2.18	2.00	1.88	1.96
Bilingual Education	4.00	4.00	4.13	4.79	4.75	4.36	4.76	4.00	4.80	4.53	4.00	4.36
Business	3.00	4.00	2.75	2.46	2.60	2.62	2.44	4.05	2.51	3.30	4.00	3.07
Computer Science	4.00	4.00	3.88	3.46	4.00	3.83	3.88	4.16	3.73	3.58	4.17	3.84
Counselor - Elementary	5.00	5.00	4.00	3.00	3.57	3.77	3.31	3.50	3.23	3.16	2.89	3.47
Counselor - Secondary	5.00	5.00	4.00	3.00	3.57	3.70	3.28	3.10	3.06	3.16	2.30	3.38
Data Processing	—	—	3.25	3.88	3.50	3.00	3.62	3.66	3.58	3.83	4.00	3.57
Driver Education	1.00	—	3.00	3.00	3.00	2.14	2.43	2.25	2.88	3.00	3.00	2.57
Elementary - Primary	5.00	2.00	3.14	3.26	2.57	2.16	3.40	3.48	1.80	2.26	2.06	2.83
Elementary - Intermediate	5.00	2.00	3.14	3.20	2.77	2.22	3.25	3.38	1.84	2.13	2.00	2.81
English	5.00	5.00	3.37	3.00	3.10	2.80	2.90	3.07	2.51	2.84	2.46	3.28
English as a Second Lang.	4.00	4.00	3.18	4.44	4.80	4.23	4.00	3.73	3.88	4.18	3.66	4.00
Health Education	1.00	4.00	1.28	1.83	1.71	1.78	1.88	2.36	1.89	1.94	2.83	2.02
Home Economics	4.00	4.00	1.86	2.30	2.00	2.23	2.88	3.06	2.04	2.75	3.00	2.66
Industrial Arts	4.00	5.00	3.00	3.00	2.16	2.41	3.33	3.09	3.00	3.20	3.33	3.23
Journalism	1.00	—	2.25	3.00	2.50	3.22	2.43	3.14	2.74	3.33	3.00	2.86
Language, Modern - French	4.00	3.00	2.71	3.00	3.20	3.22	3.35	4.04	3.10	3.24	2.57	3.22
Language, Modern - German	3.00	3.00	2.57	3.16	3.00	3.19	3.46	4.28	3.06	3.15	2.50	3.12
Language, Modern - Spanish	4.00	3.00	3.57	3.86	4.25	3.86	3.63	4.04	3.89	3.37	4.86	3.76
Language - Other	4.00	3.00	3.00	3.28	3.75	3.40	3.62	3.64	3.71	3.16	3.00	3.41
Library Science	5.00	5.00	3.20	4.14	3.00	3.78	3.70	3.36	3.88	3.33	3.00	3.78
Mathematics	4.00	5.00	3.37	4.35	3.37	3.81	4.10	4.21	3.71	3.71	3.54	3.91
Music - Instrumental	5.00	2.00	3.88	3.25	3.43	3.57	3.16	3.16	2.79	2.52	2.75	3.23
Music - Vocal	5.00	2.00	4.12	3.06	3.00	3.57	2.86	2.86	2.75	2.65	2.75	3.12
Physical Education	2.00	1.00	1.43	2.27	1.43	1.41	1.84	2.06	1.56	1.70	2.14	1.72
Psychologist (School)	5.00	4.00	4.00	3.77	4.16	3.86	3.63	3.16	3.70	3.93	3.40	3.85
Science - Biology	4.00	2.00	2.75	3.80	2.88	3.12	3.80	3.78	3.29	3.13	3.00	3.17
Science - Chemistry	4.00	4.00	3.37	3.86	3.88	3.70	3.80	3.72	3.74	2.97	3.20	3.62
Science - Earth	2.00	3.00	3.12	3.60	2.62	3.24	2.88	3.81	3.20	3.25	3.14	3.15
Science - General	4.00	3.00	3.11	3.46	2.80	[illegible]	[illegible]	3.71	3.32	3.17	3.00	3.26
Science - Physics	4.00	4.00	3.71	4.10	3.70	[illegible]	4.05	4.37	3.77	3.89	3.86	3.93
Science - Other Areas	3.00	4.00	3.25	3.44	2.50	3.23	3.86	3.86	3.39	3.80	3.00	3.36
Social Sciences	2.00	1.00	1.43	3.26	1.44	1.84	2.17	2.08	1.73	2.03	2.10	1.89
Social Worker (School)	4.00	3.00	2.83	3.33	3.50	2.82	2.50	3.08	2.90	2.00	3.00	2.96
Speech	1.00	3.00	2.87	2.36	3.00	2.78	2.88	3.21	2.64	3.10	4.00	2.78
Special Ed - Deaf	5.00	4.00	4.29	4.62	4.80	4.38	4.71	4.38	3.86	3.50	4.33	4.34
Special Ed - ED/BD	5.00	4.00	4.57	4.88	4.80	4.62	4.54	4.61	4.27	4.10	3.86	4.46
Special Ed - Gifted	2.00	4.00	3.86	3.86	4.00	4.17	4.23	4.33	3.73	3.93	3.50	3.78
Special Ed - LD	5.00	5.00	4.86	4.33	4.66	4.43	4.48	4.84	4.23	4.05	4.00	4.49
Special Ed - Mental Hand.	5.00	5.00	4.75	4.36	4.66	4.19	4.63	4.62	4.10	4.10	4.00	4.48
Special Ed - Multi Hand.	5.00	4.00	4.75	4.50	4.83	4.25	4.54	4.47	3.88	4.05	4.00	4.39
Special Ed - Reading	5.00	3.00	4.00	3.13	3.66	3.19	3.80	3.77	3.27	3.32	2.80	3.55
Special Ed - Other	—	—	4.33	3.60	4.66	3.87	4.80	4.20	3.61	4.00	3.00	3.98
Speech Path./Audio.	5.00	5.00	4.80	3.75	5.00	4.47	4.33	4.00	4.18	4.21	4.00	4.41
COMPOSITE	3.74	3.54	3.30	3.42	3.35	3.28	3.42	3.57	3.19	3.25	3.20	3.38

ASCUS Research Report

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Table 1
Estimated Demand for Classroom Teachers Public Elementary and Secondary Schools (In Thousands)

Year	Total Teacher Demand	Demand for Additional Teachers: Total	Per Enrollment Changes	Per Teacher/Pupil Ratio Changes	Per Teacher Turnover
1985	2119	138	1	10	127
1986	2135	143	3	13	127
1987	2151	144	1	16	128
1988	2162	140	-1	12	129
1989	2179	146	5	12	129
1990	2209	160	19	11	130
1991	2253	178	30	14	132
1992	2299	181	38	10	136

Source: U.S. Department of Education, National Center for Educational Statistics. Projections of Educational Statistics to 1992.

Table 2
Total Teachers Prepared By Select Institutions

Year	Number of Teachers
1968-69	86,870
1969-70	73,799
1970-71	78,841
1971-72	81,814
1972-73	78,033
1973-74	73,790
1974-75	64,880
1975-76	66,406
1976-77	58,038
1977-78	48,881
1978-79	44,960
1979-80	41,818
1980-81	39,210
1981-82	37,297
1982-83	34,862
1983-84	33,838
1984-85	32,903
1985-86	33,534
1986-87	34,383

Table 3
Estimated Supply of New Teachers Compared With Estimated Demand for Additional Teachers 1970 – 1992 Based on Intermediate Alternative Projections (All Figures in Thousands)

Year (Fall)		Estimated Supply of New Teacher Graduates	Estimated Demand for Additional Teachers	Supply as a Percent of Demand
1970		284	206	138.5
1971		314	163	192.6
1972		317	179	177.1
1973		313	175	178.9
1974		279	183	152.5
1975		238	186	128.0
1976		222	160	148.0
1977		194	181	107.2
	1973-77	1246	875	142.4
1978		161	138	131.2
1979		163	129	126.4
1980		144	127	113.4
1981		141	110	128.2
1982		143	143	100.0
	1978-82	772	647	119.3
Intermediate Alternative Projections				
1983		146	148	98.6
1984		146	142	102.8
1985		144	157	91.7
1986		142	170	83.5
1987		140	160	87.5
	1983-87	718	777	92.4
1988		139	164	84.8
1989		139	173	80.3
1990		139	183	76.0
1991		138	185	70.8
1992		137	209	65.6

Source: U.S. Department of Education, National Center for Educational Statistics. Projections of Educational Statistics to 1992.

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Table 4

Comparative Perceptions of Public School Employers and Teacher Placement Officials of Supply/Demand Condition by Subjects and Areas

Rank ordered by Subject and Area from greatest undersupply to greatest oversupply. 3.00 represents a balance. Numbers above 3.00 represent an undersupply; numbers below 3.00 represent an oversupply. The first number in each pair represents the responses of school personnal officials; the second number in each pair represents the responses of placement office officials.

Minority Teachers (All Levels)	4.28 4.28
Physics	4.24 4.32
Chemistry	4.06 4.25
Mathematics	3.98 4.26
Multiply Handicapped (All Levels)	4.03 4.04
Visually Impared (All Levels)	4.05 3.95
Deaf Education (All Levels)	4.02 3.82
Secondary Computer Education	3.88 3.90
Learning Disabled (All Levels)	3.57 3.96
Speech & Hearing Therapy (All Levels)	3.70 3.85
Elementary Computer Education	3.67 3.86
Spanish	3.70 3.74
Other Languages	3.84 3.53
Mentally Retarded (All Levels)	3.54 3.82
Earth Science	3.57 3.70
German	3.83 3.42
French	3.71 3.54
Secondary Gifted Education	3.70 3.54
Elementary Gifted Education	3.63 3.60
School Psychologist (All Levels)	3.60 3.62
General Science	3.30 3.57
Biology	3.31 3.48
Elementary Library	3.43 3.28
Secondary Library	3.42 3.27
Industrial Arts	3.40 3.24
Secondary Reading	3.26 3.33
Elementary Guidance	3.23 3.29
Distributive Education	3.27 3.05
Agriculture	3.34 2.94
Elementary Reading	3.04 3.23
Secondary Guidance	3.12 3.12
Instrumental Music (All Levels)	3.08 3.04
English/Language Arts	2.86 3.10
Business Education	3.02 2.91
Vocal Music (All Levels)	3.00 2.90
Speech/Drama/Theatre	3.17 2.63
Pre-Kindergarten	2.83 2.78
Elementary Art	2.84 2.48
Home Economics	2.81 2.45
Secondary Art	2.79 2.41
Elementary Education (Grades K – 6)	2.18 2.60
Health Education	2.45 2.05
Elementary Physical Education	2.18 2.19
Social Studies	1.98 2.23
Secondary Physical Education (Female)	1.98 1.81
Secondary Physical Education (Male)	1.87 1.73

102D CONGRESS
1ST SESSION

H. R. 709

To amend the Higher Education Act of 1965 to provide reduced rates of interest under the Guaranteed Student Loan Program to individuals who enter the teaching profession.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 29, 1991

Mr. SHAW (for himself, Mr. PENNY, Mr. FRANK of Massachusetts, Mr. POSHARD, Ms. ROS-LEHTINEN, Mr. PAXON, Mr. SKEEN, Mr. HORTON, Mr. MORAN, Mr. STEARNS, Mr. TOWNS, Mr. ROE, Mr. DORGAN of North Dakota, Mr. FALEOMAVAEGA, Mr. WOLPE, Mr. MACHTLEY, Mr. PORTER, Mrs. COLLINS of Illinois, Mr. GALLEGLY, Mr. GEJDENSON, Mr. LIPINSKI, Mr. LAGOMARSINO, Ms. SLAUGHTER of New York, Mr. JOHNSTON of Florida, Mr. CHAPMAN, Mr. SMITH of Florida, Mr. WALSH, Mr. PALLONE, Mr. WASHINGTON, Mrs. SCHROEDER, Mr. KOSTMAYER, and Mrs. MEYERS of Kansas) introduced the following bill; which was referred to the Committee on Education and Labor

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A BILL

To amend the Higher Education Act of 1965 to provide reduced rates of interest under the Guaranteed Student Loan Program to individuals who enter the teaching profession.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 427A of the Higher Education Act of 1965 is amended—

(1) redesignating subsections (f) and (g) as subsections (g) and (h); and

(2) by inserting after subsection (e) the following new subsection:

"(f) RATES FOR BORROWERS WHO ENTER THE TEACHING PROFESSION.—Notwithstanding subsections (a), (b), and (d) of this section, with respect to a loan (other than a loan made pursuant to section 428A, 428B, or 428C) to any borrower who qualifies for and obtains a deferment under section 427(a)(2)(C)(vi) or 428(b)(1)(M)(vi) for service as a full-time teacher for three years, the applicable rate of interest shall be 4 percent per year on the unpaid balance of the loan during the period from the end of such deferment and until the end of the repayment period or until the borrower ceases to be a full-time teacher, whichever first occurs.".

Chairman FORD. I thank both of you gentlemen for taking the time to prepare your statements and help this committee as we consider reauthorization. We appreciate your assistance and also appreciate the ideas that you present.

One question, Mr. Penny, what do you think is the most important determinant of whether a medical student chooses to seek a short or a long-term residency?

Mr. PENNY. I believe it has to do with, right now, lifelong income and where the rewards seem to be in the field of medicine. We have a lot of specialties today where there are tremendous rewards. As the field of medicine seems to move into highly specialized areas, the income guarantees for someone who specializes in heart surgeries and other specialized areas are tremendous.

It is a discouragement for many to go into general practice, family practice, because the payment levels, income levels, for those practices are far less. It is a discouragement for anyone to go into practice in a rural setting, where there is really no reward for specialization. For example, I have communities in my district that can't support an obstetrician or a gynecologist, because they don't have enough population base to make that a worthwhile living in a rural setting.

So I think part of it is driven by the specialties, and those specialties are rewarded with very lucrative incomes and general practitioners are not, and that has really driven the industry in the last number of years.

Chairman FORD. Well, that's the part that has us questioning how we establish some balance here. You put emphasis, for example, on the fact that we really ought to be helping people who are making some sort of a commitment toward service in less lucrative areas where the population is more widely dispersed, but the long-term trained dermatologist, for example, is not going to be a general practitioner in the country, and that's where you are going to see the long residency.

The heart surgeon, as you mentioned, may be another one, but, again, there isn't enough heart surgery in rural areas. You are almost aiming them at high-populated areas where those specialties will pay off.

Is there a way you could balance this out so that it did in fact favor the person who was going to the short-term residency because they were satisfied that what they really wanted to do was be healers among the folks?

Mr. PENNY. Well, I think there is a way to work it in that direction. I know that Mr. Murphy has an alternate bill which does try to target the deferment in that fashion. We may want to explore the types of practices where we do have shortages, or we may want to consider the area in which these individuals would serve and target it in that fashion.

I would only stipulate that when the restriction on this deferment was adopted a few years back, it was estimated that it would save us $10 million. Now, there would be some inflation factor as to how much it would cost to restore a full deferment for all these medical students on into the future, but it's in that cost range.

So, as you compare and contrast with the other objectives you want to achieve in this committee, if you can't afford a full restoration of the deferment, looking at a deferment for an extra year, perhaps, or 2 years, instead of a full deferment for all the years of a residency or an apprenticeship might be appropriate, or targeting it in some way would also be worth consideration.

Chairman **Ford**. Well, I don't want to hold you up, because we all have to go to vote, but I have just instructed the staff to ask the Congressional Budget Office to cost both of your proposals out with the amount of interest that you have generated. At some stage, we will have to decide yes or no, we do or don't want to do these things. And I don't propose to consider matters of this kind without knowing what they cost.

Mr. **Penny**. Mr. Chairman, I can only give you the figure that was released at the time that this change was made, and that was $10 million back in 1989.

Chairman **Ford**. We have those numbers. We have the numbers that they were willing to grant as savings when we backed away, but I'm not at all sure that those aren't shaped on the wrong side. We will ask them for a straight-up statement now.

Mr. Shaw, this committee has tried every way we could possibly wiggle to get some kind of deferment to encourage teachers, because we have known for 10 years that we were going to be where we are now looking at a 3 million teacher shortage, not in the future, but right around the corner. And it has been resisted by budget makers over and over again.

It survived on this side the last reauthorization but didn't survive the conference, because the Senate conferees absolutely refused to "break the budget," as they put it. I don't think we are going to be tied down that tight this time, and I hope you can encourage members to consider the long-term investment aspects of this.

Since it was during the Eisenhower Administration that the idea of loan forgiveness for teachers first came to life, and it was during the Reagan Administration that it was opposed so strongly, it would be sort of symmetrically nice to have the Bush Administration sign a bill that once again forgave teacher indebtedness and encouraged us to get more teachers, thereby identifying more with the Eisenhower Administration than with the Reagan Administration. As an admirer of President Bush, I would like to see him do that.

Mr. **Shaw**. Well, Mr. Chairman, my bill is fairly narrowly drawn. It applies only to teachers in the areas of greatest need, not to areas where there are sufficient numbers or excess of teachers, where we are seeing layoffs, and it cuts the interest payment in half rather than forgive it.

So, with the October budget reconciliation bill and the need to find the revenue to be the locomotive pulling these various bills that you will be considering, I think that this bill is at least as sharply drawn as it possibly can be in order to attack the problem and also minimize the impact on the budget.

Chairman **Ford**. Thank you.

Mr. **Penny**. Mr. Chairman, could I also ask consent to include in the record a statement from the Medical Society of the State of New York?

Chairman **Ford**. Certainly. Without objection, it will be inserted. I thank you gentlemen very much for your time this morning.

[Whereas the hearing was adjourned.]

[Additional material submitted for the record follows.]

Insert 4

Distinguished Chairman and Members of Congress:

I thank you for the opportunity to make a statement to this distinguished Committee. My name is Paul Pipia and I serve as chairman of the Resident Physician Section of the Medical Society of the State of New York, I hope to speak for all residents who financed their medical educations through student loans. We desparately need your help.

No one expects a medical education to be free. However, tuition costs at the 12 medical schools in New York State average $55,000. Eight of these schools are private schools where the average tuition is $72,000 over the course of 4 years. Tuition expenses, of course, do not include the cost of books, room and board, and other necessary expenses. I personally owe $61,000 and so I am deeply concerned about the changes that were made regarding student loans. The new laws concerning deferment greatly changed how I had planned to repay my loans.

As the son of a bus driver, I had little chance to personally finance a medical school education. I found myself in a rather common situation: I had the skills to become a physician and only lacked the financial resources to attend medical school. I was thankful that a student loan program existed. Through the student loan program, it was possible to finance a medical education, defer payments during residency and deduct the interest on loans. Today, this is no longer a reality.

The plans that I made in 1984 were drastically changed by the Omnibus Reconcilliation Act of 1989 which scaled back the

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deferment of Title IV loans. In 1984, when I financed my medical education, loan repayment was deferred throughout one's entire residency. It was crystal clear at that time that no resident could afford to repay their loans on the small stipend a resident would receive.

Financially disadvantaged students were encouraged to borrow when the security of a loan deferment policy existed. In 1989, 91% of the minority graduates had financed their education through student loans. Those who made their plans before the law was changed were not grandfathered into the agreements of the old law; but they are forced to abide by the new rules.

Presently, residents are allowed a six month grace period and two year deferral. At the end of that time, they are required to begin repayment of their student loans. Most residencies are four years long, though some may extend as long as seven years. For many physicians, it would be impossible to begin repayment during their residency. To use myself as an example, $61,000 is to be repaid at approximately $800 per month for ten years. My current monthly take home pay after taxes is $1,700. That is almost half of my monthly salary. Many residents have families to support and will find it impossible to repay their loans at such a burdensome time. Physicians are always thought to "make a lot of money." However, residents earn an average salary of $28,000 for an eighty hour work week.

The alternative that has been offered to us is that of forbearance. Under this plan, one can put off payments but a penalty in the number of years to repay and increased interest is incurred. If you originally have ten years to repay your loan, but you need two years of deferment, it will be granted with the understanding that you now have eight years to complete the financing terms. Within these rules, I would have eight years to repay the $61,000 in addition to a penalty (the accruing interest) which would greatly increase my monthly payments. In all sincerity, I would not be able to afford such a burden and would be forced to default on my student loans. Many times physicians' specialty decisions are determined by their ability to repay their loans.

Please keep in mind that we are not asking for new consideration, rather we ask that you restore what was originally guaranteed to all residents under the terms of their original loan. Please pass student loan reform! In so doing, you will allow those residents before OBRA '89 to continue with their previous plans and allow financially disadvantaged students to pursue a medical education.

If student loan reform is not passed, it will cause many residents financial hardship, force others to default and establish the precedent that medical education is not for those with exceptional ability, but rather for those with the ability to pay the cost of tuition.

I trust, ladies and gentlemen that you won't let this happen.

Respectfully submitted,

Paul A. Pipia, MD
Chairman, MSSNY Resident Physician Section

STATEMENT

OF THE

ASSOCIATION OF AMERICAN MEDICAL COLLEGES

FOR THE RECORD

ON

THE REAUTHORIZATION OF THE HIGHER EDUCATION ACT
JUNE 19, 1991

HOUSE EDUCATION AND LABOR COMMITTEE
SUBCOMMITTEE ON POSTSECONDARY EDUCATION
CHAIRMAN WILLIAM FORD

aamc

Association of American Medical Colleges / One Dupont Circle, N.W. / Washington, D.C. 20036 / (202) 828-0525

The Association of American Medical Colleges (AAMC) appreciates the opportunity to submit our recommendations on the reauthorization of the Higher Education Act of 1965. The AAMC represents the nation's 126 medical schools, 65,000 medical students, 420 teaching hospitals and 90 academic societies whose members are dedicated to providing leadership on policies to educate medical students, train physicians, develop advances in medical knowledge and improve the delivery of health care. The AAMC believes the federal role in higher education is essential. The lengthy process of medical education would be beyond the means of many students, if it were not for federal student financial assistance. The Higher Education Act of 1965, in spite of current problems, constitutes a fundamentally sound set of policies that over the past 25 years has enabled millions of Americans to realize aspirations and goals that have, in turn, benefitted society and strengthened the nation.

The AAMC has concerns in a number of areas. First, we share the view that grant assistance at the undergraduate level is inadequate. While aggregate funding of the Pell program has increased over the last decade, annual appropriations have not kept pace with increases in the cost of education and a Pell grant now covers 20 percent less of a student's college expenses than it did in 1979. This means students, particularly from low-income and disadvantaged backgrounds are either being overburdened with education debts or they are foregoing a college education. The increasing default rate in the Guaranteed Student Loan programs, which has shaken public confidence and support, is due in part to the imbalance in federal funding of grants and loans. In addition to the default problem, the increasing indebtedness will only act as a further disincentive to the pursuit of medical education, especially for low-income and minority students who continue to be underrepresented in the profession.

For medical schools and students, the issue of rising levels of debt is a pressing problem. We are concerned about the effect excessive debt may have on access to medical education, size of repayment burden, and loan default. The imbalance of grants and loans faces the undergraduate and medical education community in a similar manner. Decreasing availability of grants and scholarships has exacerbated the debt burden for the most needy medical students.

Federal grant support for medical students is available through a few modest scholarship programs administered by the Department of Health and Human Services (HHS). In the 1989-90 academic year, medical students received $3 million in federal funds for Exceptional Financial Need (EFN) scholarships which provided assistance to 532 students with an average award of $5,639. Through the Financial Assistance for Disadvantaged Health Professions Students (FADHPS) program, schools received $3.6 million and assisted approximately 1,500 students with average awards of $2,400. The National Health Service Corps, underfunded for several years, provides a small but highly beneficial source of service-connected scholarships and a loan repayment program for health professions students. The positions available in the corps are far fewer than the number seeking such support. Finally, service-connected military scholarships assist about 2,900 medical students. While these four programs help enhance access to careers in medicine and are critically important components of federal financial aid for medical students, the proportion of total aid provided by these programs is extremely small, particularly for the very few needy students fortunate enough to receive them.

The Department of Education also plays a significant role in awarding financial aid to graduate and professional students. The Department of Education's post-baccalaureate programs address both the nation's human resources needs and the expansion of individual opportunity. Professional education provides access to careers critically important to the nation. The Department of Education can play a distinctive federal role in supporting medical education by focusing on enhancing the quality and diversity of medical schools across the country through more grant assistance to medical students. To assist disadvantaged students seeking careers in the health professions, the Department should administer a competitively funded program providing grants to institutions to support students seeking professional degrees. Such a program could be established by expanding current eligibility for the Patricia Roberts Harris Public Service fellowship program, or establishing a second program component to provide grant support to students who choose careers that serve the public interest, such as a physician working in a nationally designated medically underserved area.

For the vast majority of medical students, loans are the primary source of financing their medical education. Seventy-nine percent of the 1990 medical graduates who borrowed to finance their education would have found it very difficult, and in many cases impossible, to finance their study of medicine without Stafford Student Loans, Supplemental Loans for Students, and campus-based Perkins Loans. Approximately 65 percent of medical students borrowed Stafford loans with an average loan size of $7,054. It is important to note that even these loan sources are often insufficient to cover the full cost of medical education, forcing many students, especially those attending private institutions, to rely on unsubsidized, market-rate loans with terms and conditions much less favorable than the Title IV loans. For example, the unsubsidized Health Education Assistance Loan (HEAL) program administered by HHS supplements Title IV financing for about 17 percent of medical students.

As borrowing has become the chief vehicle to financing professional education, heightened attention is being focused on recent escalation in educational debt levels of medical school graduates. In the past decade, medical school graduate indebtedness has increased almost 200 percent. For the 79 percent who borrowed, the average 1990 medical school graduate's total debt (including medical and pre-medical loans) was $46,224; over twelve percent of graduates had debt in excess of $75,000. Minority students acquire a higher average debt of $51,000; 21 percent graduate with debt in excess of $75,000. Such debts are unmanageable for many borrowers, particularly in the first few years of repayment when a significant number of graduates are still in professional training programs. A medical school graduate must complete a residency training program, lasting between three and seven years, to become a board-certified physician. During this three to seven year training period, medical residents earn annual stipends ranging from $25,000 to $35,000, depending on their residency year and region of the country. Clearly, a recent medical school graduate's debt-to-income ratio makes loan repayment very difficult during their postgraduate training and early years of practice.

The medical education community is studying the affect indebtedness may be having on an individual's decision to pursue professional education, medical specialty choice, and practice location. The consequences of high debt may frustrate our ability to reduce current shortages in the number of primary care practitioners as well as to correct the geographic maldistribution of physician manpower. The AAMC is also concerned about the relationship between high debt and default. While the rate of default in the Stafford program is very low for medical graduates, the dollar default rate is a concern because of the amounts borrowed by medical students.

In order to address these and other concerns, the AAMC recommends several changes to programs within the Higher Education Act.

Lengthen Title IV Student Loan Deferments To At Least Three Years: As stated above, medical school graduates are required to complete an accredited residency program in order to obtain hospital practice privileges. Currently, deferment of payment on Title IV loans ends after the second year of residency training. Although provisions have been made to assist medical students through the institution of mandatory forbearance, this option is more costly to students because during forbearance interest that must be paid by the borrower accrues on the total amount of the loan. Deferment of loan repayment is critical to those medical residents still in training because their debt to income ratio during residency is insufficient to enable the resident to meet large monthly loan obligations and family living expenses. Extending the deferment period beyond two years can assist residents by structuring repayment to the time when they have completed their post-graduate training and thus have the ability to repay their loans. The period of greatest difficulty for a medical resident is the period when a resident must begin to repay a high educational debt while earning a relatively low residency stipend compared to the debt level. During the third year after medical school graduation, at a point when Title IV loans enter repayment, a typical resident is earning $28,000 per year. Repayment of an average educational debt requires over 30 percent of the resident's gross pay per month - a figure which easily approaches 50 percent of take-home pay. This is the case for an average resident. Many students graduate with debts higher than average, and the percentage of take-home pay required for debt repayment may force increasing numbers of residents into default. The AAMC urges Congress to lengthen the deferment period for residents to at least three years, the minimum training period required to enter general internal medicine, general pediatrics or family practice.

Increase Stafford Loan Limits: An increased Stafford Loan limit for medical students would assist students, particularly the economically disadvantaged, from acquiring excessive debt, by permitting more students to borrow a higher percentage of their required funds from a subsidized loan program. Congress should support an increase in the annual Stafford loan limit for graduate and professional students from the current $7,500 to $10,000. Such an increase would ease the long term loan repayment obligations for medical students.

Increase SLS Loan Limits: The Supplemental Loans for Students (SLS) program has provided an essential loan resource for funding medical students who have borrowed the annual maximum under the Stafford Loan program. SLS interest is not subsidized, except when it exceeds 12 percent, and therefore, costs the federal government relatively little. It has the advantage of being eligible for consolidation with other Title IV loans during repayment. A student is not required to demonstrate financial need, other than SLS eligibility, which allows middle-income borrowers access to additional capital necessary to finance their medical education. Increasing the annual SLS limit from $4,000 to $15,000 for graduate and professional students would enable these students to reduce their reliance on other higher interest loans, and in effect, reduce their overall indebtedness.

Perkins Loan Program: The Perkins Loan program is an exceptionally beneficial loan for students and a sound investment for institutions and the federal government. With a statutorily specified low interest rate of 5 percent, Perkins loans are among the most attractive federal loans available to students. In addition, none of the Perkins money is required for lender allowances; administrative costs are extremely small and annual capital contributions and recycled funds are used for financial assistance to students. Emphasizing the inclusion of graduate and professional students would make clear to institutions Congress's intent to consider these students when they allocate funds. Increased participation in the Perkins program would enable more economically disadvantaged graduate and professional students to reduce their overall indebtedness. We urge Congress to specify in the statute that graduate and professional students should participate in the Perkins program. Moreover, in recognizing the erosion in the value of loans due to inflation over the past decade, an increase in the Perkins loan limit will assist economically disadvantaged graduate and professional students in their initial educational years. The AAMC recommends that Congress increase the aggregate borrowing limit for health professions students from $18,000 to $20,000.

Patricia Roberts Harris Graduate Fellowships (IX-B): The Department of Education administers two Harris graduate programs. The program has provided valuable assistance to colleges and universities in attracting underrepresented students into post-baccalaureate programs. The Harris Graduate Fellowship Program awards grants to support students enrolled in master's and selected professional programs. The Harris program should be increased to award grant aid to an expanded population of graduate and professional students, including health professions students. The Harris Public Service Fellowship program should provide grant assistance to health professions students who agree to serve in a nationally defined health professions shortage area.

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Allow The Use Of Estimated-Year Income For Determining Financial Need Among Graduate And Professional Students: The use of base-year income penalizes a large proportion of post-baccalaureate students who have worked for a year or more after completing their undergraduate education. Financial aid administrators have authority to exercise professional judgment and use projected current year income when they believe it would provide a more appropriate determination of a student's expected contribution. This authority is crucial, but since the use of base-year income is inappropriate for so many graduate and professional students, use of current year estimates should be the rule. Professional judgement should be applied to the exceptions where base-year income would be most appropriate.

Improve Title IV Loan Consolidation Programs And Include The HEAL Program Under The Loan Consolidation Program: The complexity of loan portfolios for medical school graduates may make loan consolidation disadvantageous. Consolidation may lead to higher interest rates, loss of deferment options, and minimum payments of no less than accrued interest. We urge Congress to evaluate the effectiveness of the current loan consolidation program in terms of the numbers of borrowers utilizing it and whether it has been successful in easing repayment burdens, particularly for the subset of professional school borrowers. In addition, under the loan consolidation program, borrowers with a minimum of $5,000 in student loan debt can refinance loans received from a variety of lenders participating in the Stafford, SLS, Perkins, and HPSL student loan programs. Typically, the monthly payments are made for a greater period of time, but consolidated monthly payments are lower than they would be in aggregate for borrowers with multiple loans, and, consequently, has the effect of reducing borrower defaults. The inclusion of the Health Education Assistance Loan (HEAL) in eligible loans for consolidation would greatly ease the repayment burden for health professions borrowers with heavy student loan debt, and facilitate the reduction of federal loan default costs.

Increase Funding For Title III And TRIO Programs For Disadvantaged And Underrepresented Minorities: Minorities are inadequately represented in the health professions. While institutions are committed to enrolling and graduating more disadvantaged and minority students, progress has been disappointing. Federal support in the form of funding for recruitment and retention grants, enrichment programs and financial aid at the professional level has been helpful, but early intervention programs are crucial in expanding the applicant pool of disadvantaged and minority students. Funding of these programs is critical to the professional sector's efforts to ensure equal educational opportunity and to expand minority representation in the health professions. Significant increases in support available through these programs should receive a high priority in reauthorization discussions.

The AAMC appreciates the opportunity to express our views on reauthorization of the Higher Education Act. We look forward to working with Congress and other interested parties to achieve our mutual goals of a healthier and better educated population.

ISBN 0-16-035717-9
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